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IMPACT OF PROPOSED CATASTROPHIC HEALTH LEGISLATION ON THE FEDERAL ANNUITANT

HEARING

BEFORE THE

SUBCOMMITTEE ON FEDERAL SERVICES,
POST OFFICE, AND CIVIL SERVICE

OF THE

COMMITTEE ON
GOVERNMENTAL AFFAIRS
UNITED STATES SENATE

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IMPACT OF PROPOSED CATASTROPHIC HEALTH LEGISLATION ON THE FEDERAL ANNUITANT

WEDNESDAY, SEPTEMBER 23, 1987

U.S. SENATE,
SUBCOMMITTEE ON FEDERAL SERVICES,
POST OFFICE, AND CIVIL SERVICE,
COMMITTEE ON GOVERNMENTAL AFFAIRS,
Washington, DC.

The Subcommittee met, pursuant to notice, at 9:30 a.m., in room 342, Dirksen Senate Office Building, Hon. David Pryor (Chairman of the Subcommittee) presiding.

Present: Senators Pryor and Roth.

OPENING STATEMENT OF SENATOR PRYOR

Senator PRYOR. Good morning. The Subcommittee will come to order.

I have a very brief opening statement.

Bringing health care to America's elderly was an idea conceived by President Truman and implemented by President Johnson with the enactment of the Medicare program in 1965. President Truman fought for the Medicare program early on because in his own words, * * * "it was the right thing to do." I, too, believe that we have a responsibility to older Americans.

As you know, Congress is expanding Medicare in order to improve health care benefits for older Americans and to provide them with better protection against devastating catastrophic medical costs. The House passed H.R. 2470 on July 22, and the Senate bill, S. 1127, is awaiting floor action.

Only recently has it come to light that the proposed Medicare legislation may impose a financial burden on Federal retirees, requiring them to pay for coverage they already have under the Federal Employees Health Benefits Program.

I understand the Senate bill treats Federal annuitants somewhat better because Medicare catastrophic coverage would be voluntary, while the House bill makes participation mandatory. Nonetheless, both versions would require Medicare beneficiaries to pay for the new benefits through increases in the Part B monthly premium and a new supplemental premium based on taxable income. Because Federal pensions are taxed, while Social Security benefits generally are not, Federal annuitants would pay a higher premium for Medicare catastrophic coverage than retirees who receive a portion of their income from Social Security.

By expanding the Medicare program, Congress is trying to help the elderly cope with catastrophic medical costs by reducing their out-of-pocket expenses. However, the Federal retiree stands to be hit with higher taxes for little or no increase in new catastrophic benefits. Federal annuitants should simply not bear a disproportionate burden in the new system.

This morning we have the opportunity to examine the impact of the proposed Medicare catastrophic legislation on Federal annuitants and the Federal Employees Health Benefit Program. I welcome your suggestions for correcting the inequities in the proposed bills, and I trust we, too, can find as Harry Truman said, "* * * the right thing to do."

Ladies and gentlemen, we have a wide variety of witnesses this morning coming before our Subcommittee.

First let me introduce a member of the Governmental Affairs Committee, Senator Bill Roth of Delaware.

OPENING STATEMENT OF SENATOR ROTH

Senator ROTH. Thank you, Dave. First of all I want to congratulate you for holding these hearings on a matter I think is of very, very critical importance. I think all of us here strongly agree that we want to help our older Americans, our senior citizens, in meeting the high cost of medical care. And like you, Mr. Chairman, as a member of the Finance Committee, I did vote to report out the Medicare catastrophic bill considered in that committee. But at the time I did so with some reservations.

My concern is this, that in an effort to help, we're going to be hurting many older Americans as well. I'm concerned that we're moving ahead without a well conceived plan that is financed in a manner that is both responsible and does not adversely affect large sections of our community. And frankly, that's the problem, Mr. Chairman, both with the legislation voted by the House bill as well as reported out by the Finance Committee.

I might say, Mr. Chairman, that during the recess, we had a number of meetings at home. And I can tell you that one group has come out very strongly against catastrophic health proposals because it says the bill is going to significantly impact them adversely. Now I underline the word adversely, on people retired both from the public sector and the private sector.

I know that we're here to consider those who are Federal retirees. We should be. Federal retirees are getting, as I think one of you gentlemen are saying, I don't want to steal your language, a double whammy. They are going to be paying twice for the same protection.

We also have the same problem, Mr. Chairman, with the military retirees where they're not being helped. I would also point out to this distinguished panel that we have the same problem in the private sector. I find out that many, many of my older Americans at home who have retired from private companies are again getting the double whammy in a slightly different fashion.

I think we've got to address this because we're not trying to help some and hurt some. We're trying to help everybody. And it's got to be financially sound.

One of the problems, as the Chairman well knows, is if certain ones opt out, then they're going to have a serious problem of how you finance the program. We are having some serious deficit problems in this country. The last thing we should do, in my judgment, Mr. Chairman, is to institute a program that's unsound, raise the hopes of the American older citizens, and then find out that we have to back off or review it and have a period of doubt as to exactly what we're going to do.

I would hope, and I congratulate you for your leadership here, that as we move forward we take each step in a responsible way that helps the older Americans and at the same time is financially sound.

So I congratulate you for what you're doing in holding these hearings today.

I have a further statement that I will not read but ask that it be printed in the record.

Senator PRYOR. Thank you, Senator Roth. So ordered.

[The statement follows:]

PREPARED STATEMENT OF SENATOR ROTH

As ranking member of the Government Affairs Committee and also a member of the Committee on Finance, I am particularly interested in the issue of Catastrophic health insurance. I look forward to today's hearing, which will focus on the impact of the proposed legislation on Federal annuitants.

For many senior citizens, depending on a fixed income means an unexpected illness can lead to an accumulation of medical bills that cause financial hardship. To protect Medicare beneficiaries from such catastrophic health care costs, I recently voted for the "Medicare Catastrophic Loss Prevention Act of 1987" when it was reported out of the Finance Committee. But I did so with reservations. While I believe that action is needed to prevent the devasting financial losses older americans experience with catastrophic health care costs, I have serious reservation about how the new benefits are financed and how the increased premiums will affect all senior citizens. I was concerned then, and I am still concerned today about the affect the higher premiums will have on all retirees. Today, we are focusing on the effect the catastrophic bill will have on Federal annuitants.

For the first time, Medicare will not be financed equally across-the-board for all beneficiaries. Today, everyone pays the same premium for Medicare for the same benefits. Under this new proposal, however, the premiums will vary according to tax liability. Specifically, in addition to an increase of four dollars in the current Medicare Part B premium, beneficiaries will pay an additional $12 for every $150 of federal tax liability up to a cap of $800 per person on the 1040 tax form. I am concerned that individuals faced with paying the higher premium may opt out of the system which will prevent them from taking advantage of the increased benefits and jeopardize the financing of the entire system.

Frankly, I believe that any action we take in this area should help the elderly, not hurt them. It is important to mention that there are other groups in addition to the Federal retirees who also would be adversely affected by the increased premium coupled with duplicated benefits. While Federal pensioners are already provided with catastrophic protection in their health plans, private sector retirees are in a similar situation. Many private sector retirees also have catastrophic plans that are provided in their retirement packages. It boils down to many Seniors being hit with a "double whammy" of having to pay twice.

I would like to bring to the Subcommittee's attention a letter I recently received from Mr. Laurence E. Ide, a resident of Delaware and a Federal retiree, who receives a minimum Social Security benefit and is covered by Medicare. Mr. Ide writes, "It is basically unfair to require those of us so situated to be included in an additional Catastrophic health care coverage under Medicare, with substantial and in some cases prohibitive additional premiums, which would duplicate similar coverage which we already have and are paying for."

He goes on to say "Dropping either Medicare or the Federal employees health benefit program is not a viable alternative. Some way must be provided so that we can opt out of the catastrophic health care coverage in Medicare, and the prescription drug benefit in Part B, if we have and are paying for similar coverage in another program." Indeed, the Blue Cross/Blue Shield plan offered as one of the many plans available for Federal Retirees, includes a catastrophic protection benefit.

Mr. Ide, from Delaware, mentions some very interesting points—points which I hope will be addressed at this hearing. I thank the Chairman of the Subcommittee, Senator Pryor, for bringing this issue to the Committee's attention. I look forward to today's testimony and, the opportunity to try and address the concerns of Federal Retirees.

Senator **Pryor**. Senator Jim Sasser of Tennessee could not be here this morning, and he has a statement that we will insert at this time into the record.

[The statement referred to follows:]

OPENING STATEMENT OF SENATOR SASSER

Mr. Chairman, I wish to commend you for holding these hearings today on the impact of pending catastrophic health care legislation on the Federal annuitant.

Recently, I held three field hearings in Tennessee—in Nashville, Memphis, and Chattanooga—on the subject of "GAPS" in pending catastrophic health care legislation.

These were most revealing hearings. We heard from men and women whose lifetime savings were wiped out because of the lack of catastrophic health care benefits. We heard from journalists and legal aid attorneys about the "Medigap" insurance scams that were being perpetrated on the elderly, and we heard from a number of health professionals about the lack of trained geriatric personnel needed for high quality health care for the elderly.

In short, our Nation's elderly are in desperate need of financial assistance in order to stave off the economic devastation that can be visited on them as a result of catastrophic illness. Pending catastrophic health care legislation simply does not fill the bill as far as many of the elderly are concerned. So the pending legislation we are considering is but only the first step in building a health insurance system that will meet the financial needs of the elderly and their families as they cope with catastrophic health care problems.

Now today this hearing uncovers another gap in the catastrophic health care proposals that we are considering.

Testimony today reveals a cruel dilemma for the Federal retiree.

The average civil service annuitant, as the National Association of Retired Federal Employees notes, will pay a new supplemental Medicare premium of $109 as a result of new catastrophic health care legislation. Yet his counterpart, with retirement benefits provided from Social Security and private benefits, will pay a new premium of $27. The Federal retiree pays a premium that is four times greater than the Social Security recipient.

Moreover, the Federal retiree receives no new major benefits as a result of this legislation. He already receives virtually all the benefits of pending catastrophic health care legislation from the Federal employee health benefits [FEHB] plan that he participates in.

In short, he is the subject of new tax for which he receives no benefits—taxation without benefit, hardly a concept that is very appealing to Federal retirees.

Many witnesses today indicate that when this legislation passes, many Federal retirees may just choose to opt out of their Federal health benefits programs.

This could seriously undermine the current health care plans, causing dramatic rises in health care premiums or major reductions in health care benefits.

We simply must find a way to eliminate the problems that I have just discussed with regard to the coverage of Federal employees in a catastrophic health care system. I know that our distinguished chairman, Senator Pryor, is working mightily to draft a legislation solution to this problem. And he may count on my support in that regard as we work to build a catastrophic health care system that helps our elderly and does not discriminate against the Federal annuitant.

Senator **Pryor**. We have a very, very strong delegation from the House and Senate this morning. Of the five members that will testify from the House and Senate, I know that four are from the State of Maryland and one is from the State of Virginia. We are very, very pleased to have them here.

I do not know quite how to handle this. I think I will call on my colleague, Senator Mikulski.

TESTIMONY OF HON. BARBARA A. MIKULSKI, U.S. SENATOR FROM THE STATE OF MARYLAND

Senator **Mikulski**. Thank you very much, Mr. Chairman, Senator Roth.

I want to thank you for holding this hearing to examine the impact of the catastrophic health bill on Federal retirees.

The catastrophic health insurance legislation pending before the Senate is a good idea with unintended, but nevertheless, very real negative consequences.

There are a great many Federal and military retirees living in Maryland, and I believe that I have heard from a good portion of them in the last two months about this legislation.

Frankly, they feel that they have been overlooked in this legislation and therefore will be unfairly overcharged in their premiums.

I support the objectives of the catastrophic bill, but object to the unfair burden placed upon this group of retirees. My constituents' complaints are justified. The bill duplicates the catastrophic benefits already provided to Federal, military and state employees. These Medicare participants will be forced to pay substantial increases in both their premiums and taxes for benefits they already receive.

The National Association of Retired Federal Employees tell me that a $600 per month Social Security survivor benefit would incur no supplemental premium, and yet a $600 civil service survivor or annuitant would incur a $90 premium.

Mr. Chairman, that's the utility bill for a month or may be what will cover the prescription drugs if we don't pay for that. I have poignant letters here from constituents, and I would like to read a paragraph from a constituent in Annapolis.

"The increase coming in our Federal health plans coupled with this increase will have to come out of our food budget and we will be practically starving. We do not think the penny coatum will cover the increased costs for retirees. Anything you can do to help Federal Employees have a decent standard of living would be appreciated."

We receive hundreds and even thousands of letters like that. I believe that we have a responsibility to these retirees to see that they are treated fairly. We must bring this issue to the Senate floor when the catastrophic bill is debated. At that time I hope to join with you in offering the amendments that will correct this inequality.

Mr. Chairman, you are on two very important committees, the Finance Committee and the Governmental Affairs Committee. Hopefully we can come up with legislation to correct this.

The Government promised its workers that they would have a sound pension system and adequate health coverage in their retirement years. They were never told that they would have to pay additionally for health benefits that were already included in their contract.

Federal employees nationwide have often been wrongly accused of double dipping. Now their own Government is going to double dip in terms of their taxation on them for the benefits they receive.

This legislation, as written, changes the rules of the game, and I think it is wrong. We now have to change the legislation. The House passed a catastrophic bill that does not treat Federal and military retirees wisely. We hope to be able to change that in the Senate.

Mr. Chairman, let me conclude by saying this. Mr. Volcker, the former Head of the Federal Reserve Board, has initiated a commission to find out how we could recruit and retain superb people in our civil service.

No young person looking at the way we are going to treat his grandmom and granddad is ever going to be attracted to Federal service because we keep changing the rules of the game as we add to their work load. This is one time to do it right. Thank you.

Senator **Pryor**. Senator Mikulski, thank you for your eloquent statement this morning.

Senator **Mikulski**. Mr. Chairman, we have a clean air markup. If I could be excused? If you have any questions please ask the wise heads of this bicameral and bipartisan delegation from Maryland at your convenience. I am also available for any questions you may have.

Senator **Pryor**. All right. I think a lot of us this morning are going to state the problem, and when we start looking for the solution, we will contact you.

Senator **Mikulski**. You know you can find me.

Senator **Roth**. Barbara, can I say I am anxious for you to go to the markup because, Mr. Chairman, there she is going to be helping us in fighting for ocean incineration. So please get over there.

Senator **Mikulski**. Thank you.

Senator **Pryor**. Thank you, Senator.

Next, I will call on Congressman Steny Hoyer. He is Chairman of the Federal Government Service Task Force. We would like to hear your statement.

TESTIMONY OF HON. STENY H. HOYER, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MARYLAND

Mr. **Hoyer**. Thank you very much for allowing us this opportunity. I am pleased to join my good friend and colleague Frank Wolf, who I might say raised this concern very significantly as the legislation was considered in the House. Tom McMillen, from our own State of Maryland, who will be testifying in effect on behalf of the Federal Service Task Force, has worked very hard on this issue, and Connie Morella, from Maryland as well, has been a new and very effective strong voice on behalf of the Federal employees on the floor of the House.

Mr. Chairman, I commend you and Senator Roth on holding this hearing today and appreciate the opportunity to testimony before this Subcommittee. As most members, I strongly support improving the Medicare catastrophic coverage as outlined in the Catastrophic Coverage Act of 1987.

Of course, no one intended by increasing catastrophic coverage for the senior citizens to unfairly penalize Federal and other contributory retirees. Therefore, we all share the common goal of resolving this unintended problem while preserving the new benefit package under Medicare.

We will hear in detail today about the extent of the problem faced by Federal and other impacted retirees who will essentially end up paying twice for the same benefit of catastrophic medical coverage. In fact, Federal, State, and local retirees will end up paying more than twice as much. This is because most public retirees annuities are subject to higher taxation than private sector retirees whose annuities are based mostly upon nontaxable Social Security benefits.

Mr. Chairman, you have suggested two alternatives which I believe provide a good basis for a solution. The first would direct OPM to study how carriers could provide plans supplemental to Medicare for Federal retirees.

Any such change would of course have an impact throughout the FEHBP system. This is because retirees, since their insurance is supplementary to Medicare, have low cost claims. Because they are paying the same rates, they provide a subsidy for all the other people who participate in a give plan. If the retirees are given a lower cost option, that cross subsidy will be reduced, meaning higher rates for other enrollees and the Government.

Since such a change is clear to have an impact, the Congress should be aware of its extent. A study is therefore in order. Such a study must have a clearly defined mission and reporting date. The study should be geared to allowing the market to respond to this situation by providing more levels of benefits than the current two high or low options. It must also include recommendations on how the Government could counterbalance the increase in costs for employees or retirees who are in the high risk categories and may be left behind. It is important that we not allow such high risk, high cost groups to fall through the cracks.

Second, Mr. Chairman, I commend you on appreciating the fact that currently Federal retirees are locked in in that they cannot leave the FEHBP system and ever return. It is my understanding that you are considering allowing Federal retirees the option to leave FEHBP and return one time in the future, in case FEHBP benefits ever again surpass the Medicare benefits. This will avoid the problem of having retirees pay twice for the same benefits now while we are waiting for the market and our studies to shake out.

I agree that in the event this legislation passes, we must provide an interim step to protect Federal retirees while the Congress examines the possibility of allowing carriers to provide new Medicare supplemental policies. One other possibility would be to delay the inclusion of Federal retirees in the new Medicare catastrophic coverage for a period of time so that they sort out the issue based upon the study that you have recommended.

In either case, Mr. Chairman, I am encouraged that remedial action is being proposed to correct this problem. We owe it to the Federal retirees to resolve this issue. Mr. Chairman, we have to remember the burdens that Federal retirees have been expected to endure recently.

In that regard, I want to reecho the remarks, as you have, of Senator Roth. It is easy for the Congress and the public sometimes to oversimplify these issues and say they only affect Federal employees or retirees, and therefore we, the overwhelming majority, don't have to worry about it.

Senator Roth correctly pointed out the adverse impact of this bill is not limited simply to Federal retirees. It does affect others.

Federal retirees have lost the benefit, as you know, Mr. Chairman, of the three year recovery rule, an issue that was before the Finance Committee last year and in December 1985. Federal retirees have seen their COLA reduced in the name of deficit reduction. Next year Federal retirees will face a 31-percent increase in FEHBP premiums and another 30-percent increase in Part B Medicare premiums.

Congress, Mr. Chairman, as you are doing, should seek to lighten the load, not weight it down any further.

I commend you and the Committee for these hearings and look forward to working with you and I know the Federal Government Service Task Force looks forward to working very closely with us as well. Thank you very much.

Senator PRYOR. Thank you very much.

I want to be very careful about how I do this. Now——

Mr. HOYER. I would suggest Mr. Wolf ought to be next.

Senator PRYOR. Pardon me?

Mr. HOYER. I think Mr. Wolf ought to be next.

Senator PRYOR. We're going to defer to our Virginia colleague next.

Congressman Frank Wolf, we welcome you this morning to the Subcommittee and look forward to your statement.

TESTIMONY OF HON. FRANK R. WOLF, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF VIRGINIA

Mr. WOLF. Thank you, Senator.

I'll be very brief. I'll summarize and put the rest in the record,[1] if I may, because Mr. Hoyer outlined a lot of the points.

I also strongly believe that catastrophic care is important. But I also believe we must address the financial concerns of the elderly on how to meet the high costs of nursing home or other long term care. A well intentioned proposal can be burdensome if the costs outweigh the gains.

Under the current legislative proposal, the vast major of the elderly, some 70 percent, already have private sector insurance policies to supplement their Medicare coverage. Facing an additional premium increase could be prohibitive. I am hopeful that the Senate will avoid the inequities found in the House version.

The House-passed legislation unfairly singled out Federal, State, military retirees, and others, as Mr. Hoyer said, to pay a disproportionate share of the cost of the catastrophic care program. Most Federal retirees are already covered for catastrophic illness because they are enrolled in the Federal Employee Health Insurance Plan as well as Medicare A and Medicare B. FEHB plans include many of the benefits that the proposals now before the Congress offer.

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[1] See p. 35.

As the legislation now stands, Federal retirees would have to pay substantially more for Medicare, but would receive practically no additional coverage. The provisions which link the tax liability and Medicare beneficiaries to taxable income are particularly unfair.

Federal annuities are fully taxed while Social Security recipients receive largely tax free benefits. The National Association of Retired Federal Employees estimates that the Federal retiree with an average annuity of $13,566 a year, which is not awfully high, but that is the average, would have to pay $530 a year in supplemental premiums while other retirees with the same income would pay only about $110 in added premiums.

This means that retirees with fully taxable exemptions, including Federal and military, would be paying substantially more for their insurance, but would be receiving practically no added benefits.

The House-passed bill would not even give these individuals a choice in the matter.

So in summary, Mr. Chairman, I thank you for these hearings. I think the problem is very clear. There ought to be some option to choose. These people ought not to be required to pay double for what they're already getting.

And I just want to again thank you and Senator Roth for having these hearings.

We didn't do this in the House. In the House side we just rushed ahead; passed things. You're so disorganized in your schedules, but at least you have the time to look at things.

We are so organized, but we don't have any time to look at things.

Senator **Pryor**. You won't find any disagreement over here with that statement.

Mr. **Hoyer**. That is not a formal Task Force position. It's a widely held view, but not a formal position.

Mr. **Wolf**. I think the fact that you are looking at it and have different rules, you can look at these things and I think we all appreciate the fact you did do this. I know you have been a good supporter of the Federal retiree and hopefully we can work out something that will help everybody.

Mr. **Hoyer**. As I said at the outset, Tom McMillen will be delivering the Task Force testimony and Congresswoman Morella has deferred to Mr. McMillen to testify now.

Ms. **Morella**. Because he's taller.

Senator **Pryor**. With Tom and Barbara Mikulski, we have the long and short of the Maryland delegation here.

Tom, we look forward to your statement.

TESTIMONY OF HON. C. THOMAS McMILLEN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MARYLAND

Mr. **McMillen**. Thank you, Mr. Chairman. I think we are covering this issue very well. I would, first of all, like to express my appreciation for the opportunity to testify before the Subcommittee. And I would like to commend you for your leadership in holding hearings on the impact of S. 1127, the Medicare Catastrophic Loss Prevention Act, on Federal and military retirees and the FEHB program.

As you know, I am here to testify not only as the Representative from the 4th District of Maryland, but in my capacity as Vice Chairman of the Federal Government Service Task Force. The Task Force[1] is a bipartisan coalition of 51 Members of the House and Senate who are concerned about issue affecting Federal employees. All members who are testifying here today are members of that Task Force.

From the outset I think it is important to note that Members of the Task Force support the expansion of catastrophic health care benefits under the Medicare program. This coverage is long overdue and represents a good first step toward improving the quality of life for America's seniors.

We are deeply concerned, however, about the impact of this legislation on Federal and military retirees. More than 4 million will be adversely affected by this legislation.

A large portion of them—2 million Federal retirees and their dependents—are incensed because the bill would require them to pay more for catastrophic health premiums than private sector retirees.

For all Medicare recipients, the catastrophic premium is based on the retiree's individual tax liability. Although the formulae to determine the premium in the Senate and House bills differ, any retiree over the age of 65 with taxable income will be charged a higher premium under the plans.

Federal retirees with the same pension as their private sector counterparts will pay significantly more because all or most of their federal annuity, unlike Social Security, is taxable.

The National Association of Retired Federal Employees has circulated an example that demonstrates the disparity in stark terms. Using the formula contained in the Senate version of the bill, the average Federal annuitant with a $14,000 a year pension would owe $109.44 for the supplemental premium. Private sector retirees with the same pension—$6,000 from Social Security and $8,000 from a private plan—would owe only $27.36. The Federal retiree ends up paying a premium four times greater than the private sector annuitant.

Compounding the problem is the fact most civil service retirees already pay for this same coverage under their Federal Employee Health Benefit Plan. In addition, more than 1.5 million military retirees and their dependents receive catastrophic health benefits at base hospitals similar to the benefits provided by the proposed catastrophic health legislation.

Many have asked why Federal retirees do not drop their FEHB coverage to avoid the duplicative coverage. Retirees are reluctant to leave the FEHB program because if they do, they are forever barred from re-enrollment.

Mr. Chairman, the additional financial burden placed on Federal retirees becomes even more pronounced when you consider two additional health benefit costs Government retirees will face next year.

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[1] See p. 139 for a list of members.

First, the Office of Personnel Management has announced an average 31 percent rise in 1988 FEHB plan premiums. Second, the Administration announced its intention to increase Part B Medicare premiums over 30 percent.

In short, Mr. Chairman, Federal retirees who pay full tax on their annuities suffer the double whammy of paying additional Medicare premiums for catastrophic coverage they already have. Our Task Force, along with many other groups, continues to grapple with possible solutions to this problem, a problem compounded by the impending premium increases that FEHBP subscribers face.

Based upon our experience with Open Seasons in the past, Mr. Chairman, I can tell you that my constituents who have retired from Federal service find what appears to lie ahead frightening—because if we do not proceed cautiously, and if we do not find an equitable solution to the difficulties posed by catastrophic coverage, we may destabilize our entire FEHB program.

I look forward to working with you and your excellent staff, Mr. Chairman, to explore a variety of proposals that will be offered to try to resolve the present problem. I salute your leadership and your willingness to hold this hearing to enable us to start that process in a timely manner. Thank you very much.

Senator **Pryor**. Thank you, Congressman McMillen.

Congresswoman Morella, we look forward to your statement and appreciate your coming.

Ms. **Morella**. Thank you. Are you still my constituent out at Briar?

Senator **Pryor**. I have actually moved into the District of Columbia. I thought about becoming your constituent now that you are here in the Congress.

TESTIMONY OF HON. CONSTANCE A. MORELLA, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MARYLAND

Ms. **Morella**. I am really delighted you have seen the need to hold this hearing with the Subcommittee, Senator Pryor. And I certainly appreciate the opportunity to reiterate my deep concern with the impact of the Medicare Catastrophic Protection Act on Federal retirees.

As you know, since we've had joint meetings before, I am a member of the House Committee on Post Office and Civil Service. And as was mentioned today, a member of the Executive Board of the Federal Government Task Force, and in Montgomery County, Maryland, I am proud to represent 26,000 Federal retirees. These are people whose careers have been public service, excellent public service.

I am particularly concerned that the problems in this bill be resolved before this legislation reaches final approval. I know that you have heard us all reiterate the same sort of thing, and I think that it does not hurt for us to realize what the problem is as we seek solutions.

As the testimony you have heard from my colleagues today reflects, these Federal retirees and some military personnel would be required to pay premiums for health benefits which they already receive through the Federal Employee Health Benefits Program, and in addition, to pay a higher income related premium than social security recipients, because Federal pensions are taxed under the formula. This double hit would take place at a time when Medicare premiums are scheduled to increase by 38.5 percent next year, and when premiums for the Federal employee health benefits program are slated to rise by an average of 31 percent.

Mr. Chairman, this burden is more than anyone should be expected to bear. These retirees live on fixed incomes and can hardly afford to pay twice for their health benefits. I urge the Subcommittee and the Senate in general to work with interested House members to resolve this situation. A solution will not be easy. Some points have been brought out. Others will be discussed by organizations like NARFE. I have asked for a GAO study to look at the situation and also to offer recommendations. Whereas the solution will not be easy to be arrived at, it can be, it will be with your leadership that you have already exemplified. The problem cannot be overlooked in the rush to approve this expansion in Medicare benefits. As was mentioned by you and by Senator Roth, in an effort to help, we have inadvertently hurt a large number of our citizens.

And so I urge you and the other members of the Subcommittee to remember the Federal retiree. We must not force this important group to sacrifice once again. And as Shakespeare once said in one of his statements, "In this business, action is eloquent."

You have always been eloquent and I know the action will be forthcoming. Thank you.

Senator **Pryor**. Thank you very much.

By the way, we do——

Ms. **Morella**. You notice I gave the attribution.

Senator **Pryor**. Yes. I want to make certain you got the right source.

By the way, we do look forward to the GAO study on this issue. Do we have any idea when that might be completed or when we may have a rough draft?

Ms. **Morella**. It should be forthcoming.

Senator **Pryor**. When you receive it, we would very much like to have it on this side of the table.

Ms. **Morella**. Yes.

Mr. **Hoyer**. By the way, they have done very good work on issues of this type. GAO has done very good work in the past and been very helpful on issues of this type.

Senator **Pryor**. This is just a little personal observation. I don't really know where this Government would be without GAO. I am a great supporter of the GAO.

By the way, Senator Paul Sarbanes does have a statement that will be placed at the appropriate place in the record.[1] Also, I would like to ask that an article by Mike Causey in this morning's Washington Post be placed in the record,[2] and any other statements that the Members of the House who have have joined us this morning.

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[1] See p. 140.

[2] See p. 174.

We would welcome any other facts, or figures, charts, graphs, tables or material.

We thank all of you very much for your kind and eloquent statements. Thank you.

Ms. Morella. Thank you.

Senator Pryor. Our first witness today is Jean Barber—our first witness, I should say, after the congressional witnesses.
should say, after the congressional witnesses.

Jean Barber is the Associate Director of the Retirement and Insurance Group, Office of Personnel Management.

Ms. Barber, we appreciate your statement.

We have several witnesses this morning. And because of the number of witnesses, we would like to ask that no witness proceed longer than 7 minutes. We are going to abide by the 7-minute rule. I hope you can summarize your statements and encapsulate them in that time frame.

Of course, your full statement will be placed in the hearing record.

Ms. Barber.

TESTIMONY OF JEAN BARBER, ASSOCIATE DIRECTOR, RETIREMENT AND INSURANCE GROUP, OFFICE OF PERSONNEL MANAGEMENT

Ms. Barber. Thank you, Senator, for inviting me this morning to present the views of the Office of Personnel Management on the impact of pending medical legislation on the FEHB program. I will summarize my statement [1] in the 7 minutes.

The current interaction between Medicare and FEHB is that we have approximately 760,000 retired Federal employees who are covered by Medicare and also participate in the FEHB. Most of these people enrolled in an FEHB plan to use it to fill in gaps in their Medicare coverage. Under current law, these gaps include both the Medicare deductible and co-insurance amounts, prescription drugs, and catastrophic coverage.

By combining the two programs, the Medicare retiree is able to secure for himself essentially first dollar coverage of most medical costs associated with acute illness.

The sizable income related premiums associated with the House-passed bill will make it extremely burdensome for this pattern of double Medicare and FEHB coverage to continue. The premium associated with the bill is large and the extra coverage is minimal.

Since the premium under the House bill is attached to the nonoptional part A of Medicare, if this bill is enacted, we would expect to see a change in the behavior of our Medicare annuitants. We would expect to see either a massive withdrawal of Medicare annuitants from the FEHB or increased pressure for a Medigap insurance plan within the FEHB for this group of people. Either of those events would have serious implications for the rest of the program.

There really are only two things we need to know to understand the impact that the bill would have on the FEHB. The first is that our retirees are concentrated in a very few plans rather than being evenly distributed over the program. Sixty-five percent of them are in the Blue Cross and Aetna plans, and five of the nearly 400 participating plans account for 80 percent of our retirees. Thus, the impact of the proposed changes will be felt very heavily in some parts of the program and some plans and hardly at all in others.

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[1] See p. 37.

The second fact that needs to be understood is that the presence of a large number of Medicare enrollees in a plan has a salutary effect on that plan. While older people are much more expensive to insure than younger people, from an FEHB perspective, since Medicare is the primary payer, retirees with Medicare A and B coverage are good risks. They have a subsidizing effect on the plans where they are enrolled. If they are withdrawn completely from the program or withdrawn into a plan of their own, we believe there will be very serious repercussions on the plans where they are now concentrated. We believe it would cause very great premium increases, for example, in the two Government-wide plans' high options. And we believe it could also precipitate the demise of those plans.

Their demise would, of course, in turn cause great turbulence in the FEHB as a whole since in this program is a great interrelation of the parts; it is a competitive program with a lot of mobility from one plan to another.

I am not saying that this legislation would cause a problem in the FEHB, rather our point is that it would highlight or bring to critical proportions a problem that is already there. That problem is the maldistribution of risks and the over-concentration of our elderly population in a few plans.

Our concern about this problem as well as our concern about a number of other difficulties that we see in the operation of the current program has caused OPM to undertake a comprehensive study of the operation of the program with a view toward legislative and administrative reform.

You have asked that we consider specifically two proposed amendments. One of them is that we undertake a study that would include the interface between FEHB and Medicare. This topic is a part of the study that we have already planned, and we have simply moved up the priority of that piece.

You may also be interested to know that we are going to try to refine and make more accurate the data that we have on the distribution of our Medicare eligible retirees. Right now we are piecing data together from a variety of sources. And while we think it's usable, it is not as good as we would like it to be. We have been in contact with the Social Security Administration and will very shortly be matching our retirement records and FEHB records against the Social Security beneficiary file, which will give us a much more accurate picture of precisely who in our program is eligible for Medicare, who is taking Medicare A and B, and how they are distributed among our plans.

The second draft amendment you asked me to review would allow Medicare eligibles to opt out of the FEHB and come back later if there is a decrease in Medicare benefits. This would undoubtedly help the Medicare eligible retirees, but it would do so, I am afraid, at the expense of the rest of the program.

We believe that only those with the greatest health care needs would come back and that would create another instance of adverse selection against the FEHB. Further, since we are talking here about nearly a million people, I would point out that it is really not possible to plan and run a program when the participation of nearly a million people is in doubt from one year to the next. Certainly it would make rate setting an almost impossible undertaking.

So we oppose that idea, because we think it would make an already volatile and unstable situation in the FEHB program truly uncontrollable.

I'll be happy to answer any questions.

Senator **Pryor**. I thank you very much.

When might we expect some sort of a study result? Do you have any indication?

Ms. **Barber**. Yes, I do, Senator. We are writing a contract to assist our staff in that undertaking and that contract will be let in the next 10 days. It calls for a report on the Medicare issue, the Medicare/FEHB issue, within 45 days of the award. The total study will cover the entire program and possible reforms and the report will be due in March of 1988.

Senator **Pryor**. We cannot get that any sooner?

Ms. **Barber**. Sir, it is a very large undertaking. If we could get it sooner, we would very much like to. If we could get pieces of it sooner, that might be helpful as well.

But the contract that was bid on had a March date for completion.

Senator **Pryor**. If we could get the GAO report and the study results that you have, you know, about the same time, it may be very helpful.

And I hope you will closely cooperate with GAO in looking at these particular problems. I think both studies would be very helpful.

Finally, does OPM have any bottom line suggestion on where we should go from here? We will soon have the catastrophic legislation on the Senate floor which may or may not see the light of day this year. The House has passed its bill.

Do you have a bottom line suggestion for us to proceed on at this time?

Ms. **Barber**. Well, I would not like to preempt the results of our study by offering conclusions now. I suppose if there's one message I have here today, it's that I don't think you can take one issue, make a small change or what may look like a small change in the FEHB program, without it having any repercussions. Those repercussions have to be analyzed and understood before any actions should be taken.

Senator **Pryor**. I hope we can agree on one thing.

Let's not allow the studies to delay facing this problem. I know that we need the facts. We need the information. But so many times we have a tendency in this town to simply have a study to delay the final confrontation with the problem, coming up with a solution. I hope I have your cooperation there. And I know that you have the Subcommittee's cooperation in pursuing that. Thank you. We appreciate your remarks. We may have some questions, and other members of the Subcommittee, for example, Senator Sasser, have indicated an interest in these matters.

We are going to leave the hearing record open for a few days so those posed written questions may be posed to you. We would appreciate your cooperation. Thank you.

Senator PRYOR. Our next witness is Mr. H. T. Steven Morrissey, President of the National Association of Retired Federal Employees.

He is accompanied by Gordon F. Brown, the National Secretary.

We welcome both of you gentlemen here this morning. We look forward to your statement. We will try to impose, once again, the 7 minute rule.

Mr. Morrissey, we look forward to your study. We know you represent a lot of fine people out there who are very concerned about this. Thank you for coming this morning The floor is yours. If you would bring that mike a little closer to you?

TESTIMONY OF H.T. STEVEN MORRISSEY, PRESIDENT, NATIONAL ASSOCIATION OF RETIRED FEDERAL EMPLOYEES, ACCOMPANIED BY GORDON F. BROWN, NATIONAL SECRETARY, AND SUSAN SHAW

Mr. MORRISSEY. Thank you, Mr. Chairman.

I would, before I start, remind you that we have a full statement for the record.[1] I tried to condense that down to 10 minutes a little while ago. You have cut me down further to 7. I'll try to meet that, but please bear with me.

Mr. Chairman, I am Steve Morrissey, President of the National Association of Retired Federal Employees [NARFE]. With me is NARFE's National Secretary, Mr. Gordon Brown, who is retired as the Assistant Director of OPM's Health Insurance Division and a recognized expert on the Federal Employees Health Benefits Program. Also we have NARFE's Legislative Representative Susan Shaw on my right.

We represent NARFE membership and 1.9 million civil service retirees and survivors. We are here today to address S. 1127 as it particularly affects Federal annuitants. This legislation would impose an unfair premium penalty on Federal retirees and survivors. It forces them to bear a disproportionate share of the cost of extended Medicare benefits which will generally duplicate health protection they already have.

In short, Federal annuitants stand to pay more than most other Medicare enrollees for benefits they do not need.

Once again, Federal retirees are faced with what can only be called a new tax. The inequity in premium computation results partially in the longstanding difference in tax treatment between social security and civil service and certain other public service retirement. In the case of an average civil service annuitant, with an income of $14,000 per year, the pending Senate bill would assess a supplemental premium of $109.44. A private sector retiree with the identical $14,000 income would be assessed only $27.36. The Federal retiree is paying 4 times more than the private sector retiree.

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[1] See p. 42.

What I believe we are all seeking here is fairness. NARFE maintains it is not possible to impose a supplemental premium fairly when that premium is based on tax liability. There must be a better way. Let's work together to find it.

How can this inequity be fixed? Our dilemma is how do you fix something that is based on all the ramifications of the Tax Code without facing the Tax Code itself?

And the Finance Committee staff has indicated that there is major opposition to tampering with the new reform tax code to fix an insurance premium computation that admittedly is imposed in an unfair manner due to that Tax Code.

Other factors relevant to this discussion are the Government pension offset and the windfall reduction formula of the Social Security Act. These laws not only result in total elimination or major reduction of social security cash benefits to which a Federal retiree might otherwise be entitled, but the income being denied is tax preferred income.

I think our point is clear. Again, we are faced with compounding of tax liabilities. The Federal retiree will pay more for catastrophic protection benefits than private sector retirees even though he doesn't need it.

There are an estimated 1.2 million Federal retirees over the age of 65 who immediately stand to be impacted unfairly by this legislation. Because of lack of coordination of Office of Personnel Management and Social Security Administration data, we are unable to determine just how many of these retirees receive social security cash benefits. And we have no way of knowing what total income an individual or family unit may have. But we do have figures on average civil service annuities as of last October when the average retiree was $13,566 and the average survivor annuity was $6,432.

From these figures and my own knowledge, I can assure you these are not wealthy people. The burden this legislation would impose on those elderly people is wide and they are afraid.

In just the past few days, they have received news about skyrocketing premiums for both their Federal Employee Health Benefit coverage and Medicare Part B. They are just now being notified that FEHB rates will increase an average of 30 percent the first of next year. And last year they were hit with the Department of Health and Human Services announcement that Medicare's flat Part B premium pay increases from $17.90 $24.80 per month next year. And this is before adoption of any extended or catastrophic coverage in the Medicare program beyond the premiums we know people are paying today for health insurance. We are dealing with estimates, conservative ones. What if we are wrong? Assumption is the mother of disaster. These catastrophic premiums could double in the next couple of years. The General Accounting Office and the Congressional Budget Office have expressed deep reservations over the out year cost that could be imposed on the annuitants.

More alarming are their findings that currently at anticipated premium levels, the average levels of this new benefits to be received exceeds average new premiums require only for those in the lowest income brackets.

We urge Congress to slow down and heed the information contained in these recent reports before imposing new benefits and new costs on the elderly that they may not want; they may not need; and may very well not be able to afford. Certainly a lesson should be learned from states which have offered catastrophic protection packages in the past. And one lesson learned is that unlimited coverage led to out of control costs which in turn led to drastically scaled back benefits.

According to the GAO report, in three of the five States that have offered catastrophic care packages, total cancellation of that coverage has been necessary.

Like millions of other older Americans, Federal retirees can and usually do carry their employer sponsored group health insurance into retirement. The average Federal retiree with standard option Blue Cross/Blue Shield will pay $29.75 per month for coverage next year for himself, a 60 percent increase. $57.58 for a couple. This is a 40 percent increase.

This is the type of FEHB plan that the majority of Federal annuitants use and find acceptable in a military supplemental policy. We believe any catastrophic legislation passed by Congress must address the need for coordination between the FEHB program and Medicare.

Plans should be available to supplement not duplicate Medicare coverage. Unless and until this is done, Federal annuitants are trapped with higher Medicare premiums than others for duplicate benefits.

In this light, Senator Pryor, we are most appreciative of your efforts and those of your staff in attempting to correct these inequities. Your proposed amendment instructing OPM to conduct a study and report to Congress on the feasibility of providing Medicare supplemental plans as options under FEHB is a good one which we can certainly support.

We would hope to cooperate with OPM in such a study. We believe that the proposal to allow Federal annuitants to drop FEHB coverage and be granted a one time opportunity to reenroll in the program at a later date if Medicare benefits are reduced would cause more problems than it would solve. For the retirees themselves, this is a burdensome proposition.

We are dealing here with an aged population all over 65 who are already frustrated and perplexed by the in's and out's of insurance coverage and enrollment and reenrollment rights.

For these reasons we recommend that the FEHB program be adjusted and coordinated with Medicare and not waived in favor of the new Medicare catastrophic benefits.

If S. 1127 were adopted in its present form, it would be more advantageous for Medicare annuitants to drop their Medicare Part B coverage altogether. And we would have to recommend this.

This type of action, however, would only cause costs in the FEHB program to spiral for everyone, the Government, the retirees, and the workers. At the same time were thousands of Federal annuitants to drop out of the Medicare catastrophic program, other taxed Medicare enrollees would have higher costs.

We believe the solution lies in getting Federal retirees the option of not participating in the new Medicare expanded coverage. The current Part B coverage interacts well with the FEHB program.

The option of allowing Federal retirees to retain the current mix of benefits is something that this body should explore.

In summary, we hope that the members of this body will work with us in correcting these inequities so that no elderly tax payer is charged more for Medicare protection than another with identical income simply because of the source or tax treatment of their income.

Thank you again for scheduling this hearing and allowing an airing of views on the impact of this legislation on the Federal retiree population. I hope that it has been helpful My staff and I look forward to working with you in solving the problems.

Senator **Pryor**. Mr. Morrissey, any additional statement you have, or those individuals who accompany you, will be welcome and placed in the record.

We are trying to build a hearing record now on which to base some intelligent, we hope, legislation on in the future.

Frankly, I don't know whether to welcome you or not this morning, because I think, if I am not mistaken, it was you or your staff, very capable staff, who found this problem existed and brought this problem before us.

I think at that time it was probably too late to make any substantive changes on the House side, and you brought them to the Senate side. Now we are going to sincerely attempt to work a way out of this problem in a constructive way.

Seriously, we do applaud you and your staff for bringing this to us. We are not going to kill the messenger at this point. We want you to know that.

Mr. Brown, do you have any comments to add to those of Mr. Morrissey?

Mr. **Brown**. No, sir. I think he covered it very well.

Mr. **Morrissey**. Mr. Chairman, I assure you our Association will work with your Subcommittee, the full Senate, and the full House to give fairness for every American in this country.

Senator **Pryor**. Thank you very much.

We have next a panel of three individuals, and I will call them. Mr. Harry Cain, who is Senior Vice President, Federal Programs Blue Cross and Blue Shield Association; Mr. Charles Bell, Vice President, Employee Benefits Division of the Aetna Life Insurance Company; and Mr. Erling Hansen, General Counsel, Group Health Association of America. We welcome you.

Once again, we are going to try to observe the 7 minute rule. Your full statements will be printed in the body of the hearing record. We appreciate the time that you have given this Subcommittee this morning.

Mr. Cain.

TESTIMONY OF HARRY P. CAIN II, SENIOR VICE PRESIDENT, FEDERAL PROGRAMS, BLUE CROSS AND BLUE SHIELD ASSOCIATION;[1] CHARLES T. BELL, VICE PRESIDENT, EMPLOYEE BENEFITS DIVISION, THE AETNA LIFE INSURANCE CO.;[2] AND ERLING HANSEN, GENERAL COUNSEL, GROUP HEALTH ASSOCIATION OF AMERICA[3]

Mr. Cain. Mr. Chairman, I am Harry Cain of the Blue Cross and Blue Shield Association.

I believe I can summarize our written text in short order.

Senator Pryor. Your written statement will be made part of the record.

Mr. Cain. Thank you.

We do quite appreciate your holding this hearing. Ever since the catastrophic proposal passed the House in July, we have been trying to figure out what the potential effect on Federal employees in the program would be and how it would be handled.

Second, I don't have to describe the problem. I think you have heard it now several times.

Third, it isn't very often we completely agree with OPM on their program. But here I think OPM has thoroughly understood the problem. And we would completely subscribe to the point of view expressed just a half an hour ago by Jean Barber. We don't have any easy answers. It is a very complicated problem. And in order to solve the one problem, you really have to open up the entire program for change. We would support, and, in fact, we urge that you begin quite soon a set of comprehensive hearings on this whole subject.

I don't think I have to go any further than that, sir.

Senator Pryor. Mr. Cain, we thank you. I may have a couple questions in a moment.

Our next witness is Mr. Charles Bell, Vice President, Employee Benefits Division, of Aetna Life Insurance Company.

Mr. Bell.

Mr. Bell. Thank you, Mr. Chairman.

Since 1960, Aetna has administered the Government-wide indemnity plan, the fourth largest plan offered by the Federal Employees Health Benefit Program [FEHB]. We are pleased that you have given us this opportunity to discuss proposed expansion of Medicare and its affect on health benefit plans available to Federal retirees.

My remarks will attempt to address three general conclusions relative to the interrelationship of expanded Medicare benefits and the operation of FEHB.

These are, first, that the proposed expansion of Medicare is of questionable necessity. Second, that regardless of what happens with Medicare, structural limitations in FEHB hamper the operation of the plan. And we believe that adverse selection encouraged by current operation of the program is creating excess cost to the Federal Government. And third, if the proposed expansion of Medicare is adopted, modification of FEHB with respect to Medicare eligible annuitants becomes an urgent imperative. These annuitants already have excellent catastrophic coverage and are paying more than their fair share for it.

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[1] See p. 54 for Mr. Cain's prepared statement.
[2] See p. 84 for Mr. Bell's prepared statement.
[3] See p. 103 Mr. Hansen's prepared statement.

The proposed changes in Medicare would force them to pay twice for this catastrophic coverage.

Medicare beneficiaries' perceived need for supplemental coverage arises from the program's substantial cost-sharing requirements.

However, the fact of the matter is that most Medicare beneficiaries, including Federal annuitants, already have coverage that effectively supplements Medicare. Nearly 70 percent of Medicare beneficiaries have either individually purchased Medigap programs or are covered by an employer's retiree health plan.

We believe the remaining beneficiaries could be reached through far less sweeping measures. And we would prefer to work with the Congress to arrange a private sector/public sector program to effectively address the real time bomb involved in the system, long-term care of the chronically ill elderly.

FEHB is a clear example of the duplication which would be introduced through Medicare expansion. Although the House and Senate versions differ in detail and approach, in each case they would limit a beneficiary's share of Medicare approved costs to about $1,700 per year. However, neither bill would pay for provider charges in excess of Medicare approved levels. Coverage of prescription drugs would be limited or non-existent, and other Medicare exclusions would remain.

The indemnity plan's catastrophic coverage is already superior to that proposed by either the House or the Senate. For Medicare eligible annuitants, the plan essentially assures that beneficiaries would receive virtually 100 percent coverage of most medical costs recognized by Medicare.

In addition, the plan covers most amounts billed in excess of Medicare allowed charges, as well as prescription drugs and preventive dental care.

In effect then, proposed legislation would simply shift payment of certain catastrophic expenses from FEHB to Medicare.

There would be no benefit to Medicare eligible annuitants. Their total premium would increase dramatically because there is no flexibility in FEHB to recognize the redundancy. This is clearly not an attractive or equitable deal from the point of view of the annuitants.

Before addressing potential solutions, however, I'd like to point out that this is merely the most visible symptom of the basic structural problems faced by FEHBP in the current environment.

Medicare eligible annuitants are heavily subsidizing other plan enrollees. The indemnity plan currently covers about 300,000 enrollees. These annuitants with Medicare make up the largest single group, currently about 120,000.

There are about 60,000 annuitants over age 65 who do not have Medicare and about 30,000 annuitants under age 65. Active Federal workers make up the remaining 90,000 indemnity plan enrollees.

All of these groups are required to pay exactly the same premium even though their actual cost profiles are substantially different. Because the indemnity plan is secondary to Medicare, Medicare eligibles are the group with the lowest average claim cost. As a result, they subsidize the other enrollees. To quantify this for you, we project that in 1988, the average claim cost for a Medicare eligible annuitant will be less than half that of an annuitant who is not eligible for Medicare, even without the proposed change in Medicare.

Each year all enrollees in FEHB have the opportunity to change plans and select an option that best meets their objective. Over the years, the necessity to increase premiums for indemnity plan participants in order to subsidize the high cost groups have caused the enrollment profile of the plan to deteriorate. Younger individuals have migrated to lower cost plans where a subsidy is not required. Those who are older with established medical problems or service relationships tend to remain behind. This further escalates the average cost profile of the indemnity plan.

Today annuitants represent approximately 70 percent of total enrollment in the indemnity plan, compared with 55 percent in 1981. Total enrollment in that time has declined by over 130,000 individuals, roughly 80 percent of them younger, healthier, active employees.

For the most part, we believe their decision to leave has been heavily influenced by relative changes in the premium cost compared with other plans. This trend has caused a severe financial strain on the indemnity plan. As importantly, however, it has created a significant excess cost burden to the Federal Government which, in a perverse way, further aggravates the problem.

In actuarial terms, this problem is called adverse selection. Simply it means that given the option, each individual will choose the plan that provides the lowest net cost for their own personal circumstances.

This creates excess Government cost because the Government contribution towards any FEHB plan is controlled by the average cost of six plans, including the indemnity plan which include a disproportionate number of annuitants. Younger, healthier employees motivated by cost tend to leave these plans for those that do not have to subsidize large numbers of annuitants. As a result, the average cost of the plans used to set the Federal subsidy rises disproportionately creating an excessive subsidy to the other plans.

We believe that the excess Federal subsidy due to this phenomenon of adverse selection could amount to tens of millions of dollars annually.

Turning specifically to Medicare eligible annuitants, enactment of a catastrophic bill will force them to seriously reconsider their participation in FEHB. They will not only be asked to subsidize other indemnity plan enrollees, they will suffer a substantial increase in total cost with no gain in benefits.

However, for them to choose to drop out of either FEHB or Medicare would be a substantial sacrifice in benefits. We believe we should seek ways to keep people in both plans in an equitable manner.

We believe that the appropriate solution is to allow carriers more flexibility in setting FEHB benefits and rates. This, in turn, would require that the formula for determining the Federal contribution to the plans would be restructured.

Long-term we propose that carriers be permitted to establish separate benefit plan options for Medicare eligible annuitants. And an important short-term interim solution is to establish premium requirements in separate groups to reflect the true underlying cost and value of benefits. These groups could, for example, be active employees, annuitants eligible for Medicare, and annuitants not eligible for Medicare.

Such a change would, of course, cause some dislocation in cost among different groups. In particular, the nominal premium for annuitants eligible for Medicare would decline while the premium for those not eligible for Medicare would rise. This emphasizes the need for concurrent restructuring of the Federal contribution toward premiums. We suggest that Government contributions be set proportionate to the underlying expected cost for each group. We believe that this can be done in a relatively straightforward way which addresses the immediate need of Federal annuitants, but which does not materially change, and over the long-term, will produce lower Federal costs than would be incurred without the change.

We are eager to cooperate with and assist this Committee to develop viable solutions to this problem.

Senator **Pryor**. We thank you for your statement, and we appreciate those facts and figures. In a moment, I am going to ask you for a suggestion.

Mr. Hansen, you are appearing today as general counsel for Group Health Association of America. We look forward to your statement.

Mr. **Hansen**. Mr. Chairman, if you could enter our written statement in the record, I will present an edited statement?

The **Chairman**. So ordered.

Mr. **Hansen**. GHAA is the national trade association for health maintenance organizations [HMO's]. We represent approximately 75 percent of the enrollment in the more than 700 HMO's nationwide. At the end of last year, nearly 26 million people were enrolled in HMO's. The Federal Employees Health Benefit Program [FEHB] is a very important program for HMO's.

In the 1988 contract year coming up, 487 HMO's, known as comprehensive medical plans by OPM, will participate in the program. These HMO's cover nearly two million people or 17.9 percent of the Federal workers and annuitants and their dependents. OPM has recently announced that 93 of these 487 are brand new HMO's being offered for the first time and that 296 existing HMO's will cost Federal employees less in 1988 than they cost this year.

You have asked us to testify today on the impact of Medicare catastrophic protection legislation on the FEHB Program. The Office of Personnel Management estimates the overall number of Medicare annuitants enrolled in the HMO's is at 76,000, which is approximately 10 percent of the total Medicare annuitants in the FEHB Program.

Generally, we believe that there may be an adverse impact of catastrophic legislation on these annuitants and on HMO's, both those which participate in the FEHB program, and those that do not.

In addition, there are currently some problems in coordinating or integrating FEHB and Medicare, which we think you may be able to address. You know HMO's already provide catastrophic protection for their enrollees. These benefits are generally equal to or in excess of general benefits provided in the House and Senate catastrophic bills.

Both bills are clearly aimed at eliminating out-of-pocket costs, primarily on the in-patient expenditure. Most HMO's provide 365 days of hospitalization, some at no additional charge, while some have modest payments.

In addition, Federally qualified HMO's and State certified HMO's are restricted in the amount they charge as a copayment, both on a per service and aggregate basis, and are prohibited from having deductibles for basic health services. Copayment caps put a lid on out-of-pocket payments and therefore provide effective catastrophic protection.

The problem for HMO's, assuming enactment of catastrophic legislation, is that most enrollees, including Federal enrollees, will not see an appreciable change in their benefits, but because of the supplemental premium based on tax liability, they may pay more for their health coverage. This issue has been dealt with in detail by other witnesses here this morning.

With regard to the two amendments to the FEHB Act which you have developed, Mr. Chairman, we are happy to say that we support these. We strongly support your amendment calling for OPM to study the feasibility of Medicare supplemental policies. We also support including such benefit packages as an additional option available to Federal employees and annuitants. Consumer choice has always been important to our members and to Federal employees. We think it is essential to promote choice and competition in the FEHB Program. Resolving the longstanding problem of inadequate coordination between FEHBP and Medicare assures this. We support this.

We also support in principle your amendment which would remove the penalties now imposed on Federal workers and annuitants disenrolled from the FEHBP by permitting them to reenroll under certain circumstances. In 1982, under TEFRA, Congress created a new type of Medicare HMO contract which was compatible with the HMO delivery system. Medicare eligibles may enroll with an HMO and receive a benefit package which is generally richer than the Medicare Part A and B benefits. In addition, the premium charged often buys out the Medicare deductibles and copayment requirements.

As of June 1987, there were 157 HMO's with Medicare risk contracts serving nearly one million people. Unfortunately, the Federal annuitant who disenrolls to join an HMO is not permitted to reenroll in the FEHBP.

This has been a significant barrier to encourage Medicare eligible Federal employees and annuitants to enroll under a Medicare risk contract. Because the Medicare risk contracts and FEHB do not interface, FEHB employees and annuitants who are Medicare eligible are not permitted to try an HMO and take advantage of a health benefits option which may offer both broader benefits and a lower premium.

We have had informal talks with OPM and the Health Care Financing Administration on this issue and understand OPM is developing a proposed regulation which would suspend, but not terminate, FEHB enrollment if the employee or annuitant wanted to become a member of a HMO with a Medicare risk contract. We would be happy to work with you, Mr. Chairman, to modify your amendment to help correct this serious problem. We appreciate the opportunity to discuss these issues and look forward to working with you in developing solutions.

Senator PRYOR. Thank you, Mr. Hansen, for your statement.

Once again, let's sort of summarize where we are.

The House has passed a piece of legislation. It seems that a large majority of the opinion expressed thus far this morning is that an injustice is being wrought on the Federal annuitants. There will be a double whammy, a double hit with coverage under the catastrophic bill.

So the Senate sees the problem, We have a catastrophic health bill before us. And now what do we do? Is there any stop gap position for the Senate to consider taking as we look to bring this legislation to a vote?

Do you have a suggestion, any of the panelists?

Mr. CAIN. Well, as our testimony suggested, one thing you could do in a hurry is to change the catastrophic proposal so that the Federal or the Governmental retiree's income is counted the same as any other retiree's income in any other sector of the economy. That would help but it wouldn't solve the problem.

To solve the problem, you would really have to change the way the total FEHBP interacts with Title 18.

Senator PRYOR. I don't know that we could do that here.

Mr. CAIN. It is a sizeable undertaking. That's right.

Senator PRYOR. I am trying to think of what we might do in this calendar year as the House and Senate begin to, hopefully, grind to a halt. And I do not know when that might be, but let's say the 1st of December.

In that time period, we are looking for a solution. Any suggestions that you have would be welcomed.

Mr. Cain, do you have a further statement?

Mr. CAIN. One other thing you could want to consider is to give this Subcommittee more time to consider the problem. One of our other responsibilities is to act as carriers and fiscal intermediaries for Medicare. And if the catastrophic proposals pass today and we have to in effect put the program into effect on the 1st of January of 1988, it would be a monumental task.

So if the program's implementation were somewhat slowed up, I do not think we would object to such an idea.

Senator PRYOR Mr. Bell?

Mr. BELL. If it is concluded that change to Medicare to introduce a catastrophic provision is appropriate and passed, I believe the focus of our comments has been that you should look at the resulting cost to the Federal annuitant who is eligible for Medicare. And that has two pieces to it.

One is the premium that everyone has to pay to acquire the catastrophic coverage. And there may be some equitable solutions here in terms of imputing income in one way or another to equalize the different sectors.

The second thing that we believe should be considered as a stopgap measure would be to give some premium relief to those people who are in the FEHB plan and who are Medicare eligible annuitants. We believe something like that could be worked out if the clearance was there to work around the existing constraints of the program.

Long-term I would agree with Mr. Cain that there are some fundamental structural things that need to be done in reworking the Federal plan. And I do endorse the study that has been initiated to work on that.

Senator Pryor. Thank you, Mr. Bell.

Mr. Hansen, do you have any suggestions for us right now?

Mr. Hansen. I think our suggestion was incorporated in our testimony, that with 487 HMO's being available in the program, next year a step should be taken to facilitate the enrollment by Medicare eligible Federal annuitants in those programs. Currently, there is not sufficient incentive for those people to join HMO's.

We think if there were more people in HMO's, then some of the over concentration problem that Ms. Barber described and the lack of adequate spreading of risk described by my colleagues here at the table, might go away.

Senator Pryor. Now, Mr. Cain, I see a negative reaction being expressed by you.

Do you have a comment on Mr. Hansen's proposal?

Mr. Cain. Yes, sir, I have. I want to say first we have quite a few HMO's ourselves, something around 57 who are participating in the Federal program. And we are very supportive of the HMO's in the program.

But if I understood what the GHAA was proposing, their proposal would allow only the Medicare eligible Federal retirees out of the FEHB to take part in the at-risk HMO's, which would compound the problem for the whole program. It would be very helpful to HMO's, but it would not be very helpful to the fundamental problem which this program confronts.

Senator Pryor. Any rebuttal?

Mr. Hansen. I would acknowledge there are still fundamental problems in the program. I was addressing my remarks only to the Medicare eligible population.

Senator Pryor. Mr. Bell, any final comments?

We have one more panel. We appreciate very much your coming. All of your statements will be printed in full in the record.

We are going to take a 5 minute recess before our next panel. [Recess.]

Senator Pryor. We now have a final panel this morning. We appreciate their giving us of their time and expertise in this area.

Our first panelist is Mr. Robert Vincenzi. Is that correct, Mr. Vincenzi?

TESTIMONY OF ROBERT VINCENZI, DIRECTOR, HEALTH INSURANCE, NATIONAL ASSOCIATION OF LETTER CARRIERS,[1] ACCOMPANIED BY HARRY BOTELER, ADMINISTRATOR, HEALTH BENEFIT PLAN; PATRICK J. NILAN, LEGISLATIVE DIRECTOR AMERICAN POSTAL WORKERS UNION;[2] DAVID SANASACK, EXECUTIVE DIRECTOR FEDERAL MANAGERS ASSOCIATION;[3] AND LARRY WALIGORA, DIRECTOR, NATIONAL RURAL LETTER CARRIERS' ASSOCIATION[4]

Mr. VINCENZI. That is correct, Senator.

Senator PRYOR. Thank you. You are accompanied by one of your colleagues, I believe?

Mr. VINCENZI. Yes. Mr. Harry Boteler, who is the Administrator of the Health Benefit Plan.

Senator PRYOR. Very good.

You are the Director of the Health Insurance National Association of Letter Carriers?

Mr. VINCENZI. That is correct.

Senator PRYOR. Then you will be followed by Patrick Nilan, who is Legislative Director of the American Postal Workers Union.

Then we have David Sanasack; is that correct?

Mr. SANASACK. Yes.

Senator PRYOR. He is the Executive Director of the Federal Managers Association.

And Larry Waligora, Director of the National Rural Letter Carriers' Association. Larry, we appreciate your coming.

Robert, your statement will be welcome. Once again, we will try to abide by the 7 minute rule.

Mr. VINCENZI. Thank you, Senator. And by the way, you did an excellent job with the name of Vincenzi. I happen to have had the privilege of being in Fayetteville, Arkansas, several weeks ago at the Arkansas Letter Carrier State Convention. They didn't handle that name as easily.

Senator PRYOR. By chance, were you there during the grape harvest?

Mr. VINCENZI. No. I was not, but I had the opportunity of using some of your local golf courses a few days.

Senator PRYOR. Good.

Mr. VINCENZI. My name is Dr. Robert W. Vincenzi, Director of the National Association of Letter Carriers' Health Benefit Plan. I have a statement to submit for the record, which I will now summarize.

The NALC firmly believes in catastrophic health care. We worked with the AFL-CIO for passage of legislation as did other members of FAIR, the Postal/Federal Coalition.

We are not an insurance company, per se. That is, we do not make a profit. Our program is based on cradle to grave coverage. In other words, 21 year old letter carriers are charged the same premium amount and receive the same coverage as retired letter carriers. As with any insurance program, our premiums are based on statistical data for this entire diverse population in which the younger members generally use fewer benefits than the older members.

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[1] See p. 109 for Dr. Vincenzi's prepared statement.
[2] See p. 118 for Mr. Nilan's prepared statement.
[3] See p. 131 for Mr. Sanasack's prepared statement.
[4] See p. 133 for Mr. Waligora's prepared statement.

In 1966 the NALC plan provided almost one-half billion dollars to its enrollees. That sum will be exceeded in 1987. Of that amount, we returned $181 million to our annuitant enrollees, who represent 34 percent of the total enrollee population.

In most cases, statistics show that annuitants covered by both Medicare and the NALC plan receive 100 percent of covered charges. If annuitants find that they cannot afford both Medicare and the NALC plan, we are afraid they will opt for the cheaper and less extensive coverage in Medicare.

Our plan cannot afford to lose that group of enrollees. Because when that happens, the premiums become volatile. Our statistics show that the premiums would soar. Nor do I think that the country wants to enlarge its sector of under-covered elderly. It runs contrary to decent health policy and means S. 1127 would have the unintended negative effect of creating more people with less coverage.

Furthermore, passing the buck back to Medicare will have two adverse monetary effects. One, raise the dollars needed from Congress to cover the elderly Federal postal population who discontinue FEHBP. And, two, raise the premiums all plans must charge the remaining enrollees. That also will cost the Government more because the Government provides a 60 percent copayment based on the average of the big six plans.

Quite frankly, S. 1127 would not significantly help retired letter carriers or any other workers who bargain for health benefits. There are many other unions in a similar position. In most cases, S. 1127 and Medicare Parts A and B offers less coverage than the Federal Employee Health Benefits plans.

For example, someone with both Medicare and NALC's plan receives 100 percent of drug bills. Someone with just Medicare will have a deductible of at least $500, according to the current proposals.

That also is true in varying degrees for hospital care, home visits and other necessary health care items.

Under the current Senate proposal, an annuitant earning $20,000 would pay $190 for no additional benefits. That's a bad deal by any standard.

This double coverage problem has several possible solutions. Through the congressional authorizing committees, instruct OPM to provide minimum benefit levels for Federal/ Postal Medicare recipients, for example, nursing home care. Have FEHBP remain the principal source of payment. At the end of the year the individual programs would present OPM a bill to cover the additional costs. Money for reimbursement would come as an entitlement from the Treasury or Congress could increase its copayment to retirees from 60 percent to 75 percent.

Currently, active letter carriers receive a 75 percent copayment because the U.S. Postal Service adds 15 percent to the Government's share.

Another solution would have a yearly Treasury entitlement reimburse the individual insurance carrier for whatever is included in the catastrophic coverage.

In conjunction with the OPM, the entitlement would be earmarked to the increased health coverage for retirees enrolled in the plans.

Since we already negotiate with OPM on costs and coverage, this proposal would not significantly change current practice. However, it would allow the plans to significantly increase other important catastrophic needs, such as eyeglasses, mammograms, and nursing home care.

Mr. Chairman, while the problem of double coverage is acute, it is not as dramatic as the inequity in the size of the tax bite which letter carriers would face. The average retired letter carrier earns a $14,000 annuity, which is fully taxed. And therein lies the problem.

Because it is taxable income, he or she would pay as much as eight times what a Social Security recipient pays. The figures on our retired carriers are: $109 a year in supplemental premiums for unnecessary coverage.

His next door neighbor, receiving the same pension including Social Security, would pay $27 a year.

That is the unfairness issue in a nutshell. The simplest solution would be treating the annuities or Federal and Postal retirees the same as Social Security.

Once again, thank you for holding these hearings. Many Members of Congress have expressed sympathy with our problem and are now searching for a solution. The only question we have is how do we reach that solution?

Senator PRYOR. Thank you for your statement this morning.

Mr. Nilan is with the American Postal Workers Union. We look forward to your statement, Mr. Nilan.

Mr. NILAN. Thank you. In an effort to cooperate with my colleagues as well as yourself as Chairman after a long morning, I will appreciate just having our statement included in the record. And I want to make a few comments and amendments which I belatedly gave the staff and which I believe you have in front of you.

Basically, what we are all concerned with, including yourself in a very excellent opening statement, is the concern over Medicare covered Federal employee covered health plan retirees—I think the problem has been properly identified by all the witnesses that have appeared.

As a matter of fact, I found the statement by the Office of Personnel Management, Jean Barber, rather interesting.

I have been the Legislative and Political Director of the American Postal Workers Union for 23 years. I do not think during that period of time I have ever found myself close to agreement with either the former Civil Service Commission and now OPM on any one issue. I find their comments very interesting. Although we do not necessarily embrace them in their entirety, but it is interesting they also have equal concern about Federal and Postal retirees, which I think is refreshing, if not unique. At least, it's one of the few times they have come up here supporting our views.

The amendment we are suggesting is, as I mentioned on the bottom of page 2 of our proposed amendment, Mr. Chairman, it is not an exact solution to the problem. Rather, it is a concept which we have included in this amendment, an effort to recognize, as all of my colleagues have indicated, the differences in tax treatment between the Social Security recipient and Federal retirees.

We are offering it for consideration by the Subcommittee and the staff in trying to draft up an equitable solution to the problem. It is on that basis in which I am offering it.

Mr. Chairman, thank you very much. We have complete confidence that you will do everything you can to protect the interest of our Postal and Federal retirees. Thank you very much.

Senator **Pryor**. I want to thank you, Mr. Nilan.

I want to also commend you for submitting to us a proposed amendment.

I am going to ask that this proposed amendment be printed in the record so we can look at it.[1]

I am not going to say that it is going to be adopted or accepted, but it gives us something to look at, and we commend you for submitting it to us.

Mr. **Nilan**. At least it is one potential concept that we feel has not been addressed yet.

Senator **Pryor**. We think it is a very constructive way to approach this problem.

Mr. David Sanasack, Executive Director of the Federal Managers Association.

Mr. **Sanasack**. Thank you.

The Federal Managers Association would like to thank the Subcommittee for inviting us to speak on the effects of the catastrophic health care protection bill on the Federal Employees Health Benefit Program. We appreciate the Subcommittee's interest in seeking to alter the inequities for public sector employees in the catastrophic plan.

There are two problems with the Senate version of the catastrophic care bill. First, civil service annuitants will pay more than those who are covered by Social Security at identical income levels for identical insurance. Unfortunately for Federal employees, the supplemental premium to pay for catastrophic coverage is based on the tax code. Most Social Security is not taxable while civil service annuities are fully taxable. Second, not only are Federal employees paying more for coverage, they are paying more for items already covered under the Federal Employee Health Benefit Program. Federal employees already have catastrophic coverage under FEHBP.

In addition to the hardship placed on our retirees by this proposed legislation, these two inequities would cause serious detriment to the FEHB program itself. Civil service retirees who leave FEHBP cannot come back into the program. They may choose that option instead of paying for double coverage. There is no telling what will happen to the overall cost of the FEHBP for both the employee and the Government if this bill becomes law.

FMA supports the concept of catastrophic health care protection, but coverage should benefit all in the plan on a equitable basis. In the bill's present form, FMA would be unable to offer its support for this legislation. The old saying of "you only get what you pay for" applies. We wish that were true.

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[1] See p. 126.

However, Federal employees are paying more and getting less.

In closing, we are asking Congress to modify the premium formula so that public sector annuitants do not pay more than other annuitants in the same income category for the same benefits. We feel Congress should coordinate the FEHB program with Medicare's expanded catastrophic benefits so the benefits are not duplicated and are not paid twice by public sector retirees. The easiest answer to this dilemma, of course, is to pass a bill similar to H.R. 1938. This bill would treat public sector retirees in the same manner as private sector retirees for purposes of taxation.

There is no easy solution to the problem created by this new catastrophic protection legislation. But we will do everything we can to help you find a solution.

Thank you for giving us this opportunity to speak before the Subcommittee. And I'd be happy to answer any questions.

Senator PRYOR. I thank you very much for your statement this morning. Your full statement will be printed in the record.

Mr. Waligora, Director of the National Rural Letter Carriers' Association.

Mr. WALIGORA. Thank you, Senator.

My name is Larry Waligora and I am the Manager of the National Rural Letter Carriers' Benefit Plan, one of the participating plans in the Federal Employees Health Benefit Program. I represent over 48,000 enrolled members, 26,000 of those members are retired employees.

It is a pleasure to join you today and share with you our concerns about a piece of legislation that is moving very rapidly through the legislative process, the Medicare Catastrophic Protection Act of 1987, and the adverse effects this legislation would have on Federal retirees.

The Congress, through legislation, created in 1959, the Federal Employees Health Benefit Program. With some fine tuning along the way, it has been an outstanding and overwhelming success as the largest employer sponsored health plan in the world. The Medicare catastrophic legislation which we are offering testimony on today would begin to seriously disrupt and dismantle this program which serves some 5 million Federal employees, retirees and surviving spouses, because it would simply offer those individuals identical coverage to that which they already have under the FEHB program and force them to pay for something from which they will get no benefit. We predict that most Federal retirees will leave the FEHB plan opting instead for only Medicare coverage. The proposed legislation would, thus, dramatically change and reduce the size of the universe of enrollees who are participating in the Federal Employee Health Benefits Program.

We also object to the catastrophic premium schedule in the proposed Senate legislation because it is based on income taxes owed. That creates difficulties since Federal retirees receive a pension from the Civil Service Retirement Trust Fund and all of the money a rural carrier annuitant receives would be considered taxable income under this legislation. An employee who retired from the private sector under similar circumstances and length of service would have a vastly different premium calculation for the same benefits. As an example, the average civil servant retiring at 62 year of age draws a monthly annuity of about $14,000 per year, all of which would be used for the calculations of the catastrophic premium. Conversely, someone retiring under a private pension plan at age 62 with about $14,000 in retirement income would most likely be receiving $6,000 of the total in Social Security benefits, none of which would be utilized in the calculation for setting the premium under this proposed legislation.

Let's examine the double coverage issue. Under our Federal health plan for catastrophic provision to kick in, a member must accrue $1,000 in out-of-pocket expenses. Under the proposed Medicare catastrophic legislation, a person must accrue $1,700 in out-of-pocket expenses. In the prescription drug area, our Federal plan picks up 100 percent of the cost for prescription medication if our retired member is also covered by Medicare Part B. Under the proposed Medicare legislation, a person must accrue $500 in prescription drug payments before Medicare would cover 80 percent of the cost of medication. Under the Rural Carrier Plan, we waive the hospital deductible for Medicare eligible people. Under our plan, we also waive the major medical deductible for retired members enrolled in Part B, and additionally we pay the two Medicare deductibles, both hospital and medical.

Let's look at the issues of changing the overall composition of the FEHB plan members and what that would do to the various plans that participate in the program and, likewise, to the Federal Government's share of the cost of the program. If the legislation being considered today becomes law and contains a premium structure similar to the current proposal with no allowance for the double coverage of Medicare eligible Federal retirees, then it is our prediction that massive numbers of retired enrollees will simply abandon their FEHB plan and opt instead for Medicare coverage alone. Since Medicare is already the primary payer of medical expenses for these retired members with the FEHB plan serving as a so-called Medicare supplement, it would seem reasonably certain that our prophecy will be fulfilled.

This, in turn, will cause a tremendous change in the demographics of each FEHB plan and will result in a tremendous premium increase to remaining enrollees. Thus, in all likelihood, the Government contribution to the program would also increase substantially under the current FEHB funding mechanism. The only enrollees left to support the program would be active employees, those retired but not yet 65 years old, and those retired over age 65 with no Medicare eligibility. It would be a tremendous financial hardship for those plan members comprising the latter two categories to pay the resulting high FEHB plan premiums.

We think that there are some things that need to be done to remedy the adverse impact of the proposed Medicare catastrophic legislation on Federal retirees. Such remedies are not simple, but rather complex.

First, some relief must be given to Federal retirees in the computation of the Medicare catastrophic premium to bring the cost in line with their private sector counterparts.

Secondly, something must be done to eliminate the double coverage that Federal retirees will be forced to pay for under the Medicare catastrophic bill. We would like to suggest very strongly that the Senate insist that the Medicare catastrophic coverage be truly voluntary insofar as participation.

For example, make the catastrophic coverage a separate and distinct part of the Medicare program like Parts A, hospital, and B, medical, already are. Such a voluntary nature would at least ensure that Federal retirees with FEHB coverage could make an educated decision on what health coverage best suited their individual situations.

However, if the Medicare catastrophic coverage remains mandatory as under the House version or is attached to Part B of Medicare as proposed by the Senate, there is no true voluntary choice. So we would hope that the Members of this Subcommittee could strongly urge the Chairman of the Senate Finance Committee to insist that the voluntary nature of the coverage be retained in conference.

Mr. Chairman, we are very grateful that you are willingly taking your time to hold a hearing on these issues which are of vital importance to the members of the National Rural Letters Carriers' Association. Thank you very much.

Senator **Pryor**. Mr. Waligora, thank you.

Once again, back to Mr. Nilan's proposal. I think if I could summarize that proposal. It looks to me like what you would do is a back door approach. If the legislation passes and if there is a double hit on the Federal annuitant, then I understand your proposal to be one where there would be $150 tax deduction for that annuitant or an exclusion or exemption. Is that correct?

Mr. **Nilan**. You are absolutely correct with your comment about the back door approach to it.

As I mentioned earlier, we had a very difficult time in looking at a solution to this problem.

Senator **Pryor**. It's unique. I want to commend you for that.

Mr. **Nilan**. I am sure the dollar constraints of the Finance Committee are involved. As I said earlier, we were just trying to find a concept which you could look at. I would also like to mention, Mr. Chairman, that the FAIR organization, which you are familiar with and which we are associated with, that when we met last week, all representatives were in support of the amendment as a concept and a starting point in this regard. We all realize that the ultimate solution, of course, would be to get into the tax structure and correct the discrepancies and discrimination. But we are offering this, as you suggested, as a back door approach to the problem.

Senator **Pryor**. I'm chairing another Subcommittee—I wear another hat around here—and that is the Finance Committee Subcommittee on Internal Revenue Service Oversight. I may run this by the IRS to let them maybe give us a little calculation of what this proposal might cost or what the benefits would be, if any.

I thank you at least for submitting to us a proposal.

We will leave the hearing record open until next Tuesday at 5 p.m. There may be questions from other members of this Subcommittee.

Any additional information to build upon the hearing record will be greatly appreciated by the panelists.

We have had four Members of the House and one from the Senate this morning.

We heard from OPM. We have had two very splendid panels. And I just want to thank each of you for your cooperation in abiding by our time constraints.

We have done this all in less than a 2 hour period.

One parting thought is, and I will quote from H.L. Mencken, he said that, "For every problem there is a solution. There is a solution that is quick, neat, simple, and wrong."

So we do not want to fall into that trap. There is no neat, quick, simple solution to the matter before us, and if we go too quickly, it might be wrong.

It's my understanding that Congressman Ackerman will be holding hearings in October, early October, on this very point. And hopefully, some of you will be invited to appear before that committee in the House of Representatives.

It is a complex issue. We are going to do our very best to address it. We thank all the witnesses and panelists this morning. This meeting stands adjourned.

[Whereupon, at 11:30 a.m., the Subcommittee adjourned to reconvene at the call of the Chair.]

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

TESTIMONY
of
Representative Frank R. Wolf
on
S. 1127 -- Catastrophic Health Insurance
before the
Federal Services, Post Office, and Civil Service Subcommittee
of the
Senate Government Affairs Committee

Mr. Chairman. Thank you for giving me this opportunity to testify today. I commend you on holding these hearings in such a timely manner because the issue we are addressing today is one of national importance. Without a doubt the time has come to recognize the changing needs of an aging America. One need that that has been clearly established since the President proposed it last year is that of protecting our elderly from the financial ruin that a catastrophic illness can bring.

I strongly believe that catastrophic care is important, but I also believe that we must address the financial concerns of the elderly on how to meet the high costs of nursing home or other long-term care. I believe that Congress needs to address the day-to-day financial problems which our elderly face when providing for their long-term care--the high costs of Medicare premiums, taxes, and long-term health care.

Even well-intentioned proposals can become burdensome if the costs outweigh the gains. Under current legislative proposals, the vast majority of the elderly--some 70 percent who already have private-sector insurance policies to supplement their Medicare coverage--would face premium increases which could be prohibitive. These individuals might be faced with a choice between dropping their Medicare coverage or dropping their private insurance. Clearly, this would be detrimental to the insurance industry.

I am hopeful that the Senate will avoid the inequities found in the House version. The House-passed legislation unfairly singled-out federal, state, and military retirees to pay a disproportionate share of the costs of the catastrophic care program. Most federal retirees are already covered for catastrophic illnesses because they are enrolled in the Federal Employee Health Benefits plan (FEHB) as well as Medicare A and Medicare B. The FEHB plans include many of the benefits that the proposals now before Congress offer. As the legislation now stands, federal retirees would have to pay substantially more for Medicare, but would receive practically no additional coverage.

The provisions which link the tax liability of Medicare beneficiaries to their taxable income are particularly unfair.

Federal annuities are fully taxed, while Social Security recipients receive largely tax-free benefits. The National Association of Retired Federal Employees (NARFE) estimates that a federal retiree, with an average annuity of $13,566 a year, would have to pay $530 a year in supplemental premiums, while other retirees with the same income would pay only about $110 in added premiums.

This means that retirees with fully taxable pensions--including federal, state, and military annuitants--will be paying substantially more for their insurance but would be receiving practically no added benefits. The House-passed plan would not even give these individuals a choice in the matter.

Mr. Chairman, I hope that the final Senate version will respond to the health care concerns of all retirees. I urge the Committee to consider the costs that individuals who have already paid for catastrophic health insurance would have to face under a major expansion of the Medicare program. These costs would be prohibitive for many individuals, would be particularly unfair to federal, state, and military retirees, and worst of all would not give our elderly a choice. Before catastrophic care legislation becomes law, these important questions need to be addressed. Thank you for your consideration.

STATEMENT OF
JEAN M. BARBER, ASSOCIATE DIRECTOR
FOR RETIREMENT AND INSURANCE
OFFICE OF PERSONNEL MANAGEMENT

FOR A HEARING OF THE

SUBCOMMITTEE ON FEDERAL SERVICES, POST OFFICE.
AND CIVIL SERVICE
COMMITTEE ON GOVERNMENTAL AFFAIRS
UNITED STATES SENATE

ON

THE IMPACT OF MEDICARE CATASTROPHIC LEGISLATION
ON THE FEHB PROGRAM

September 23, 1987

MR. CHAIRMAN AND MEMBERS OF THE SUBCOMMITTEE;

THANK YOU FOR INVITING ME TO APPEAR TODAY TO PRESENT THE VIEWS OF THE OFFICE OF PERSONNEL MANAGEMENT ON THE IMPACT OF PENDING MEDICARE LEGISLATION ON THE FEDERAL EMPLOYEES HEALTH BENEFITS (FEHB) PROGRAM AND ON FEDERAL ANNUITANTS.

I WOULD BEGIN BY NOTING THAT THE ADMINISTRATION STRONGLY OPPOSES THE HOUSE-PASSED VERSION OF THE MEDICARE CATASTROPHIC MEDICAL EXPENSE LEGISLATION. WE URGE THAT CONGRESS RETURN TO PRINCIPLES GUIDING THE ORIGINAL CATASTROPHIC MEDICAL EXPENSE LEGISLATION PROPOSED BY PRESIDENT REAGAN ON FEBRUARY 24, 1987. HOWEVER, I AM NOT HERE TO DISCUSS THE MERITS OF THE CATASTROPHIC HEALTH LEGISLATION, BUT ITS IMPACT ON THE FEHB PROGRAM.

TO ASSURE THAT OUR DISCUSSION PROCEEDS FROM A COMMON UNDERSTANDING OF THE INTERACTION BETWEEN MEDICARE AND FEHB, I WOULD LIKE TO REVIEW BRIEFLY THE CURRENT SITUATION.

THE OVERWHELMING MAJORITY--78 PERCENT--OF FEDERAL RETIREES CHOOSE TO PARTICIPATE IN THE FEHB PROGRAM. OF THIS GROUP, A LARGE MAJORITY (APPROXIMATELY 760,000) OF THOSE AGE 65 AND OLDER ARE ALSO COVERED BY PART A OF MEDICARE, AND MOST ALSO ELECT COVERAGE UNDER PART B. TYPICALLY, A MEDICARE ELIGIBLE RETIREE ENROLLS IN AN FEHB PLAN TO "FILL THE GAPS" IN HIS MEDICARE COVERAGE. UNDER CURRENT LAW, THESE "GAPS" INCLUDE BOTH THE MEDICARE DEDUCTIBLE AND CO-INSURANCE AMOUNTS, PLUS PRESCRIPTION DRUG AND CATASTROPHIC COVERAGE. BY COMBINING THE TWO PROGRAMS, THE RETIREE IS ABLE TO PROTECT HIMSELF AGAINST MOST MEDICAL COSTS ASSOCIATED WITH ACUTE ILLNESS.

THE SIZABLE, INCOME-RELATED PREMIUMS ASSOCIATED WITH THE EXPANDED MEDICARE COVERAGE SUCH AS UNDER H.R. 2470 COULD MAKE IT EXTREMELY BURDENSOME FOR FEDERAL ANNUITANTS TO CONTINUE TO CARRY BOTH FULL MEDICARE AND FEHB COVERAGE. SINCE THE HOUSE BILL ATTACHES A SUPPLEMENTAL PREMIUM TO THE NONOPTIONAL MEDICARE PART A AND PROVIDES A PRESCRIPTION DRUG BENEFIT AS WELL, WE WOULD ANTICIPATE, IF THIS BILL WERE ENACTED, A MASSIVE WITHDRAWAL OF MEDICARE ANNUITANTS FROM THE FEDERAL EMPLOYEES

PROGRAM. WE MIGHT ALSO SEE INCREASED PRESSURE FOR A SEPARATE "MEDICAP" INSURANCE PLAN WITHIN THE FEHB. ANY OF THESE EVENTS WOULD HAVE SERIOUS PROGRAM IMPLICATIONS.

TWO FACTS ARE NECESSARY TO UNDERSTAND THE IMPACT OF THE PENDING MEDICARE LEGISLATION ON THE FEHB. FIRST, FEDERAL RETIREES, INCLUDING MEDICARE ELIGIBLES, ARE CONCENTRATED IN A VERY FEW PLANS. SIXTY-FIVE PERCENT OF ALL FEDERAL RETIREES ARE ENROLLED IN THE BLUE CROSS AND AETNA PLANS AND 5 OF THE NEARLY 400 PARTICIPATING PLANS ACCOUNT FOR 80 PERCENT OF TOTAL ANNUITANT ENROLLMENT. THUS, THE IMPACT OF CHANGES IN MEDICARE AND IN THE BEHAVIOR OF MEDICARE ELIGIBLES WILL NOT FALL EVENLY ON FEHB PLANS--SOME WILL BE STRONGLY AFFECTED AND OTHERS HARDLY AT ALL.

SECOND, THE PRESENCE OF A LARGE NUMBER OF MEDICARE ENROLLEES GENERALLY HAS A SALUTARY EFFECT ON THE PLANS IN WHICH THOSE INDIVIDUALS ARE ENROLLED. WHILE OLDER PEOPLE IN GENERAL ARE FAR MORE EXPENSIVE TO INSURE THAN YOUNGER PEOPLE, FROM AN FEHB PRESPECTIVE, SINCE MEDICARE IS THE PRIMARY PAYER, RETIREES WITH MEDICARE A AND B COVERAGE ARE RELATIVELY GOOD RISKS. THUS, THEIR PRESENCE IN PLANS WITH EXPENSIVE POPULATIONS OF NON-MEDICARE ELIGIBLES HELPS SPREAD THE RISK OVER A BROADER BASE. IF THE SUPPLEMENTAL PREMIUM ASSOCIATED WITH THE HOUSE BILL'S PROVISIONS LEADS INDIVIDUALS TO WITHDRAW FROM SUCH PLANS, THIS WOULD RESULT IN HIGHER PREMIUMS FOR THOSE REMAINING. THE

SEVERITY OF THE PREMIUM INCREASE WILL DEPEND ON THE PARTICULAR MIX OF ENROLLEES IN A GIVEN PLAN. WE BELIEVE THE INCREASE FOR THE HIGH OPTIONS OF THE TWO GOVERNMENTWIDE PLANS COULD BE VERY SIGNIFICANT AND IT IS POSSIBLE THAT THEIR CONTINUED VIABILITY WOULD BE THREATENED. THE DEMISE OF THESE PLANS WOULD, OF COURSE, CREATE CONSIDERABLE TURBULENCE IN THE PROGRAM.

YOU ASKED THAT WE COMMENT ON TWO DRAFT AMENDMENTS TO THE FEHB LAW THAT DEAL WITH THE IMPACT OF THE PENDING MEDICARE LEGISLATION. THE FIRST AMENDMENT WOULD REQUIRE OPM TO UNDERTAKE A STUDY OF THE FEASIBILITY OF OFFERING SUPPLEMENTARY MEDICARE INSURANCE UNDER THE PROGRAM. AS IT HAPPENS, WE WILL SHORTLY AWARD A CONTRACT FOR A COMPREHENSIVE EVALUATION OF THE FEHB WHICH INCLUDES AN ANALYSIS OF MEDICARE/FEHB INTERACTION. CONSIDERATION OF A SEPARATE INSURANCE VEHICLE FOR MEDICARE ELIGIBLES IS A LOGICAL PART OF THE WORKPLAN AND HENCE, WE WOULD HAVE NO OBJECTION TO THIS AMENDMENT, ALTHOUGH WE BELIEVE IT IS UNNECESSARY.

YOU MAY ALSO BE INTERESTED TO KNOW THAT IN SUPPORT OF OUR CONTRACTOR'S EFFORT AND OUR OWN ON-GOING STUDY OF THE PROGRAM, WE HAVE LAUNCHED AN EFFORT TO SECURE MORE ACCURATE AND COMPLETE DATA ON OUR MEDICARE ELIGIBLE RETIREES. THE DATA WE HAVE CURRENTLY IS PIECED TOGETHER FROM A VARIETY OF SOURCES AND

WHILE WE THINK WE UNDERSTAND THE GENERAL SIZE AND SCOPE OF THE ISSUES, MORE EXACT INFORMATION IS REQUIRED FOR CLOSE ANALYSIS. WE ARE CURRENTLY WORKING WITH THE SOCIAL SECURITY ADMINISTRATION TO MATCH ENROLLMENT INFORMATION FROM OUR ANNUITY RECORDS WITH MEDICARE DATA IN THEIR MASTER BENEFICIARY FILE.

THE SECOND DRAFT AMENDMENT YOU ASKED US TO REVIEW WOULD ALLOW MEDICARE ELIGIBLES TO OPT OUT OF FEHB AND GET BACK IN IF, AT SOME LATER DATE, MEDICARE BENEFITS ARE CURTAILED. THIS AMENDMENT WOULD PROTECT THE INTERESTS OF MEDICARE ELIGIBLES BUT IT WOULD DO SO AT THE EXPENSE OF THE REST OF THE PROGRAM. SINCE ONLY THOSE WITH THE GREATEST NEED FOR HEALTH CARE ARE LIKELY TO OPT BACK IN, OUR PLANS WOULD BE EXPOSED TO CONSIDERABLE ADVERSE SELECTION. FURTHER, IT IS SIMPLY NOT POSSIBLE TO SET RATES OR RUN AN ORDERLY PROGRAM WHEN THE PARTICIPATION OF NEARLY A MILLION PEOPLE IS IN DOUBT. WE BELIEVE THIS AMENDMENT WOULD MAKE AN ALREADY VOLATILE AND UNSTABLE SITUATION IN THE PROGRAM TRULY UNCONTROLLABLE.

I WILL BE HAPPY TO ANSWER ANY QUESTIONS.

NATIONAL ASSOCIATION OF RETIRED FEDERAL EMPLOYEES
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STATEMENT OF THE NATIONAL ASSOCIATION OF RETIRED FEDERAL EMPLOYEES BEFORE THE SENATE COMMITTEE ON GOVERNMENTAL AFFAIRS SUBCOMMITTEE ON FEDERAL SERVICES, POST OFFICE & CIVIL SERVICE ON PROVISIONS OF S. 1127 THE MEDICARE CATASTROPHIC BILL

Wednesday, September 23, 1987

Mr. Chairman, I am H. T. Steve Morrissey, President of the National Association of Retired Federal Employees (NARFE). I am accompanied this morning by NARFE's National Secretary, Mr. Gordon Brown, who is retired from the position of Assistant Director of OPM's Health Insurance Division and a recognized expert on the Federal Employees Health Benefits Program (FEHBP). Also with us today is our Legislative Representative Susan Shaw. On behalf of NARFE, we greatly appreciate this opportunity to appear before you and this Subcommittee to present our concerns regarding S. 1127, the pending Medicare Catastrophic Health Care Bill.

While we appear in direct representation of NARFE's own membership of almost half a million federal workers, retirees and survivor annuitants, I believe we speak for the more than 1.9 million civil service retirees and survivors when we say we have grave concerns for the impact this legislation will have on their health insurance—both cost and coverage.

Mr. Chairman, since early this year when legislation was first introduced to amend Medicare to provide "catastrophic" health care protection for older Americans, NARFE has joined with other retiree organizations in voicing our general concerns about the continued vulnerability of the elderly to the real health care catastrophe—the cost of long term nursing home and home health care needs, as well as the emerging new concept of basing Medicare premiums on income.

Champion of Retired Federal Employees

We still have those concerns, but we are here today to address two very real problems with the current Medicare catastrophic care bill, S. 1127, as it particularly affects federal annuitants. One specific problem is the fact that this legislation would impose an unfair premium penalty on federal retirees and survivors. It forces them to bear a disproportionate share of the cost of extended Medicare benefits which will generally duplicate health protection they already have. In short, federal annuitants stand to pay more than most other Medicare enrollees for benefits they do not need.

Let me first address the issue of premium inequity in this bill. It must be recognized that once again, federal retirees are faced with what can only be called a new tax. In just the past year, civil service retirees have been constantly jerked about by tax changes which have thrown earlier financial plans totally out of kilter. They have been stunned by the retroactive elimination of the tax code's three-year rule, then surprised by taxation of their new lump sum annuity option, and now this—a tax-based premium for catastrophic health insurance protection which they already pay for and have. And to add insult to injury, they will find themselves paying more for this unneeded coverage than their social security or private sector counterparts at identical income levels.

The inequity in premium computation under this bill results partially from the long-standing difference in tax treatment between social security and civil service (and certain other public service) retirement income. Social security cash benefits are tax preferred income, not subject to taxation until all income exceeds a certain level, and at most, only one-half of an individual's social security is ever taxable. Federal annuities are fully taxable at any and all income levels. This basic difference in the tax treatment of these two sources of government retirement benefits alone results in major differences in the supplemental premium for individuals with identical incomes.

In the case of an average civil service annuitant with an income of $14,000 per year, the pending Senate bill would assess a supplemental premium of $109.44 (in 1989). A private sector retiree with the identical $14,000 income, composed of the current average social security benefit supplemented by an employer-sponsored retirement plan income would pay a supplemental premium of $27.36. Here are two individuals with identical incomes being taxed for identical insurance protection, yet the federal retiree is paying four times more than the private sector retiree.

Beyond this difference in tax treatment of retirement income, the fact that S. 1127 would base the Medicare supplemental premium on the amount of taxes a person owes, creates an impossible situation. Every allowable deduction or income shelter provided for in the tax code plays through to this final calculation of a premium assessment.

Mr. Chairman, what I believe we are all seeking here is fairness. NARFE maintains that it is not possible to impose a supplemental premium fairly when that premium is based on one's tax liability. There must be a better way, and we hope to work with Congress to find it.

We have been asked numerous times, "How can this inequity be fixed?" Our dilemma is this--how do you fix something that is based on all of the ramifications of the tax code without fixing the tax code itself? And the Finance Committee staff has indicated that there is major opposition to tampering with the newly reformed tax code to fix an insurance premium computation that admittedly is imposed in an unfair manner due to the tax code.

A good example of a further complication of determining premiums based on tax liability could be found in a person retiring at age 65, electing the lump sum annuity option, most of which is subject to tax, and finding that retirement election compounds into a hefty increase in his or her Medicare health insurance premium for the year.

Other factors relevant to this discussion are the Government Pension Offset and the windfall reduction formula of the Social Security Act. These laws not only result in total elimination or major reduction of social security cash benefits to which a federal retiree might otherwise be entitled, but the income being denied is tax preferred income. This means that because of social security covered employment of their spouses or of their own, they have Medicare entitlement. But they are denied the accompanying tax-preferred social security income given others, and under the proposed supplemental premium formula, they can still end up paying more than others for Medicare.

I think our point is clear. We once again are faced with a compounding of tax liabilities that affect only public sector retirees. The culmination of all of these factors is that the federal retiree will pay more for catastrophic protection benefits than private sector retirees, even if he doesn't need it. It's another case of a tax imposed unfairly on federal retirees. We should not even be asked to support such a bill that is so patently unfair to those who chose to spend their careers in government service.

There are an estimated 1.2 million federal retirees and survivors over age 65 who immediately stand to be impacted unfairly by this legislation. Because of a lack of coordination of Office of Personnel Management (OPM) and Social Security Administration (SSA) data, we have been unable to determine just how many of these retirees receive social security cash benefits, and we have no way of knowing what total income an individual or family unit may have. But we do have figures on average civil service annuities as of last October, when the average retiree annuity was $13,566 and the average survivor annuity was $6,432.

From these figures and my own knowledge, I can assure you, Mr. Chairman, that these are not extraordinarily wealthy people. In very real terms, the burden this legislation would impose on these elderly people is weighty, and they are afraid. In just the past few days, they have received news about skyrocketing premiums for both their Federal Employees Health Benefits (FEHB) coverage, and Medicare Part B. They are just now being notified that FEHB rates will increase an average of 30 percent the first of next year, and last week they were hit with the Department of Health and Human Services' (HHS) announcement that Medicare's flat Part B premium may increase from $17.90 to $24.80 per month next year. This is $6.90 per month more than they currently pay for Part B before we even talk about adding catastrophic coverage. This is the largest annual Part B increase in the program's history, and is reportedly due to increased utilization and doctor's charges. And again, this is before adoption of any extended or catastrophic coverage in the Medicare program.

Mr. Chairman, beyond the premiums we know people are paying today for health insurance, we are dealing with estimates. And we are using conservative ones. What if we are wrong? It is entirely possible that these catastrophic premiums could double in the next couple of years. Congress' own General Accounting Office (GAO), as well as the Congressional Budget Office (CBO), have expressed deep reservations over the out-year costs that could be imposed on annuitants. Even more alarming are their findings that at currently anticipated premium levels, the average value of new benefits to be received exceeds average new premiums required only for those in the lowest income brackets.

We urge Congress to slow down and heed the information contained in these recent reports before imposing new benefits and new costs on the elderly that they may not want, may not need, and may very well not be able to afford.

Certainly, lessons should be learned from states which have offered catastrophic protection packages in the past. And one lesson learned is that unlimited coverage led to out-of-control costs, which in turn led to drastically scaled back benefits.

According to the GAO report, in three of the five states that have offered catastrophic care packages, total cancellation of that coverage has been necessary.

As I pointed out earlier, most federal retirees do not need this coverage as they already have catastrophic protection through the FEHB Program. And so they are understandably asking why they should be forced to pay more than others for benefits they do not even need.

Like millions of other older Americans, federal retirees can, and usually do, carry their employer-sponsored group health insurance into retirement. And it is not cheap. The average federal retiree with Standard Option Blue Cross-Blue Shield will pay $29.75 per month for that coverage next year.

This is the type of FEHB plan coverage that the majority of Federal annuitants use and find acceptable as a Medicare supplemental policy. While S. 1127 gives private Medigap policies a defined period of time to adjust their benefit and premium structures so as not to duplicate the new and expanded Medicare coverage, this charge is not extended to employer-sponsored health insurance such as the FEHB plans.

We beleive any catastrophic legislation passed by Congress must address the need for coordination between the FEHB program and Medicare. Plans should be available to supplement, not duplicate Medicare coverage. Unless and until this is done, Federal annuitants are trapped with higher Medicare premiums than others for duplicate benefits.

In this light, we are most appreciative, Senator Pryor of your efforts and those of your staff in attempting to correct these inequities.

Your proposed amendment instructing OPM to conduct a study and report to Congress on the feasibility of providing Medicare supplemental plans as options under FEHB is a good one which we could certainly support. We would hope to cooperate with OPM in such a study.

We believe the proposal to allow Federal annuitants to drop FEHB coverage and be granted a one time opportunity to reenroll in the program at a later date if Medicare benefits are reduced would cause more problems than it would solve. For the retirees themselves this is a burdensome proposition. We are dealing here with an aged population, all over age 65, who are already frustrated and perplexed by the in's and out's of insurance policy coverage, and enrollment and reenrollment rights. And beyond that, when their FEHB group insurance policies are part of their total retirement package, why should they be placed in the situation of having to give up this coverage? Certainly this amendment would also carry an administrative burden for the FEHB program and its individual plans.

For these reasons, we recommend that the FEHB program be adjusted and coordinated with Medicare and not waived in favor of the new Medicare catastrophic benefits. We believe, in fact, that if S. 1127 were adopted in its present form, it would be more advantageous for Federal annuitants to drop their Medicare Part B coverage altogether, and we would have to so recommend. This type of action, however, would only cause costs in the FEHB program to spiral for everyone — the government employer, the retirees and the workers. At the same time, were thousands of Federal annuitants to drop out of the Medicare catastrophic program, other taxed Medicare enrollees would have higher costs.

Perhaps, the solution lies in giving Federal retirees the option of not participating in the new Medicare expanded coverage. The current Part B coverage interacts well with the FEHB program. We suggest that the option of allowing Federal retirees to retain the current mix of benefits is something that this body should explore.

In summary, we hope that the members of this body will work with us in correcting these inequities so that no elderly taxpayer is charged more for Medicare protection than another with identical income simply because of the source or tax treatment of their income.

Thank you again for scheduling this hearing and allowing an airing of views on the impact of this legislation on the Federal retiree population. I hope that it has been helpful. My staff and I look forward to working with you in solving the problems that have been presented here today.

ADDITIONAL COST IN NEW PREMIUMS
VS
AVERAGE BENEFITS PAYABLE

SENATE PLAN

Assumptions compare the income of a Civil Service retiree (CS) with a Private Sector retiree. A $6000.00 Social Security benefit (SS) is used, as this is close to the average currently payable. Retirees are assumed to be age 65 and single. The new supplemental premium is figured by using the 1989 rate of $1.14 per month for each $150.00 of tax liability. Tax liability was arrived at by using $6000.00 as an average combined standard deduction and personal exemption, then utilizing a tax rate of 15%. Projected new costs and new benefits are for calendar year 1989.

	Civil Service Retiree	Private Sector Retiree
Annual Income	$14,000.00 (all CS)	$14,000.00 ($6000 SS, 8000 other)
Part B Increase	54.00	54.00
New Supplemental Premium Increase	109.44	27.36
Total New Cost	163.44*	81.36*
CBO Projected New Benefit	140.00	140.00

Annual Income	$20,000.00 (all CS)	$20,000.00 ($6000 SS, 14000 other)
Part B Increase	54.00	54.00
New Supplemental	191.52	109.44
Total New Cost	245.52*	163.44*
CBO Projected New Benefit	124.00	124.00

Annual Income	$25,000.00 (all CS)	$25,000.00 ($6000 SS, 19000 other)
Part B Increase	54.00	54.00
New Supplemental	259.92	177.84
Total New Cost	313.92*	231.84*
CBO Projected New Benefit	124.00	124.00

*Total new cost figures do not include the estimated $6.90 per month Part B increase ($82.80 per person for 1988) if the premium goes from $17.90 to $24.80, as projected by the Department of Health and Human Services.

National Association of Retired Federal Employees 9/21/87

RESPONSES OF
THE NATIONAL ASSOCIATION OF RETIRED FEDERAL EMPLOYEES
TO QUESTIONS SUBMITTED BY SENATOR SASSER

1. The retired Federal annuitant, who has devoted his or her career to serving the public, seems to be placed in a unique position by proposed catastrophic health legislation. It would tie premiums to income, that is, ability to pay, which in principle is quite understandable. But by rendering "taxable" income the benchmark, the House and Senate bills place the annuitant at a disadvantage vis-a-vis his counterpart on social security. They may receive the same annual disposable income, but the Federal retiree's "looks" larger because it is taxable. And the seeming unfairness is compounded, as I've said and as I've heard here today, because the Federal retiree isn't even getting new benefits for this disproportionately large payment. He or she is paying twice for catastrophic coverage.

Is that a fair assessment of the legislation's impact? And am I correct that the Federal retiree is unique in this sense? Or do you know of any other categories of eligibles who could voice a similar complaint?

RESPONSE:

The Senator's assessment of the inequities imposed on Federal annuitants by provisions of the pending Medicare Catastrophic Health Care Bill, S. 1127, is certainly a fair one, and reflects his understanding of the concerns NARFE has raised on behalf of its membership and other Federal retirees.

Although we believe retired Federal employees constitute the largest group to be adversely affected by the formula currently proposed for computing an individual's new Medicare supplemental premium, there would be certain other groups similarly affected. These would include certain state and local government retirees, including some retired teachers, fire-fighters, etc. who had little or no Social Security covered employment. While there are today very few American workers not covered by Social Security, in past years there were several categories of employment not covered. Former workers in such employment categories would be among today's Medicare-eligible population.

There would also be other Medicare enrollees for whom the proposed extended provisions of S. 1127 would duplicate catastrophic protection they already have through employer-sponsored health insurance plans. However, most of these private sector retirees would not be faced with paying twice for duplicate coverage, as the majority of them have the cost of their employer-sponsored insurance—usually plans designed to coordinate with Medicare at age 65—fully paid by the former employer.

2. Suppose the legislation is amended so that the Federal annuitant's premium is calculated on the same, or a nearly similar basis, as the Social Security recipient's. This wouldn't resolve the whole issue, I know, because the Federal worker would still be paying two times for the same thing, but at least not paying nearly so much. Would you comment on the viability of such a change?

RESPONSE:

NARFE believes that it is possible to develop a supplemental premium formula which would give a credit to persons with little or no Social Security income and thus equalize the income premium ratio of Federal (or public) retirees and Social Security (or private sector) retirees. Unless and until that is done, a grave inequity exists in the proposed bill, and NARFE cannot and will not support it.

3. Specifically, do you have some idea what proportion of catastrophic health care eligibles are represented by Federal annuitants? If as I suspect it is a very small fraction, then would the premium revenues foregone, by treating the Federal worker the same as his Social Security counterpart, in any way threaten the integrity of the catastrophic health insurance system?

RESPONSE:

While there seems to be some question on the exact number of Federal annuitants currently enrolled in Medicare, the Office of Personnel Management (OPM) has said that some 760,000 annuitants, less than 3 percent of the total Medicare-covered population, have full Medicare coverage. But regardless of the percentage of Federal annuitants involved, the revenues resulting from treating Federal retirees the same as Social Security recipients in the premium computation formula should not be at issue. Even if premiums have to be re-evaluated for everyone concerned, there can be no justification for enacting new legislation known from the start to be discriminating. We see no threat to the fiscal integrity of the Medicare catastrophic system, but unless this premium formula is corrected, there is considerable threat to the integrity of a Congress which would allow such blatant and documented discrimination to go unchecked.

4. Would it be practicable in your view to exempt Federal annuity recipients entirely from the catastrophic health scheme, without forcing them to forego other Medicare benefits they would enjoy? How would this affect the integrity of the system? And again, would this be a complete and equitable solution to a unique problem -- or might other groups claim similar entitlement to an exemption?

RESPONSE:

NARFE believes it could be practical to make the newly proposed catastrophic coverage optional for Federal retirees, or indeed for others also. Even if this option necessitated a slight increase in the standard premium for those who did not elect the catastrophic coverage, it would not mandate duplicative coverage for persons who don't want it, don't need it, and can't afford it. If the cost of optional catastrophic coverage were competitive with the same coverage from private insurers, we believe most retirees would want it and elect it. We believe such an option would be no more detrimental to the integrity of the system than the current proposal, since if forced to pay twice for duplicate coverage many may simply decide to drop their Medicare altogether.

5. Do you wish to make any other specific suggestion how the pending legislation could be amended, to take account of the issues raised by this hearing regarding Federal retirees?

RESPONSE:

Our main concern at this time is to assure that if pending Medicare catastrophic legislation is enacted, it does not force Federal retirees to pay a disproportionate share of the costs of new benefits which they do not need. But as we have stated before, we believe that Congress should rethink this extended coverage plan completely and give more thought and concern to the real catastrophic health care costs fearfully faced by older Americans—long term nursing home and home health care costs. This is the type of coverage the majority of all retirees have been proven to want, need, and it is coverage for which they are willing to help pay. We believe that Senator Sasser's bill, S. 454, is a much better effort at addressing these real catastrophic costs than the current legislation.

TESTIMONY

of the

BLUE CROSS AND BLUE SHIELD ASSOCIATION

on

EFFECT OF MEDICARE CATASTROPHIC PROPOSALS on the FEDERAL EMPLOYEES HEALTH BENEFITS PROGRAM

before the

SUBCOMMITTEE ON FEDERAL SERVICES, POST OFFICE,
AND CIVIL SERVICES

COMMITTEE ON GOVERNMENTAL AFFAIRS

UNITED STATES SENATE

by

Harry P. Cain, II
Senior Vice President
Federal Programs

Wednesday, September 23, 1987

Mr. Chairman, I am Harry Cain, Senior Vice President of the Blue Cross and Blue Shield Association. On behalf of the 78 Blue Cross and Blue Shield Plans that participate in the Federal Employees Health Benefits Program (FEHBP), I want to express our appreciation both for the subcommittee's action in holding this hearing, and for the opportunity to testify.

The Blue Cross and Blue Shield Association has supported the concepts underlying the Medicare catastrophic proposals which both Houses of Congress have been considering. In particular, by extending Medicare to provide catastrophic benefits to all beneficiaries, the proposals assure that many low income elderly who now have neither private Medigap nor Medicaid coverage will be protected. Moreover, a financing structure tied to taxable income will assure that this coverage does not place too heavy a financial burden on the low income beneficiaries. Unfortunately, given the particular benefits and financing mechanisms proposed in H.R. 2470 and in S. 1127, these bills would have some unintended negative effects on federal annuitants who participate in FEHBP and are also Medicare beneficiaries.

The purpose of this testimony is to provide our view of the proposed Medicare catastrophic bills' impact on the FEHBP in general and on the Blue Cross and Blue Shield Government-wide Service Benefit Plan (which we refer to as our Federal Employee Program, or FEP) in particular.

In the last several weeks, we have looked at this problem from many different angles, and have tried to formulate possible solutions that would not adversely affect other aspects of the FEHBP. At this point, we do not believe that such a solution is available. We believe that, with the exception of an adjustment in the treatment of retirement income, any short term "fix" -- such as refunds, or more benefits, or a Medigap option for annuitants -- is either impractical or will create additional problems for the entire program. Our bottom-line conclusion is that the problem posed by the Medicare catastrophic proposals should be addressed and resolved only in the context of more comprehensive changes in the FEHBP.

The Immediate Problem

Let me briefly review the impact that the catastrophic proposals would have if there are no other changes in the overall FEHBP.

First, the current situation:

Our Subscribers who are federal annuitants and who are also Medicare beneficiaries are already covered for nearly all of the benefits which would be added by S. 1127 or by H.R. 2470, plus important additional benefits. For these beneficiaries, we cover the Medicare deductibles and copayments, we waive our own deductibles and copayments, we provide more mental health and home nursing care, and we cover 100 percent of prescription drugs. In addition, these beneficiaries generally will pay less for medical fees which are in excess of the Medicare payment allowances on unassigned claims. We do not, however, cover skilled nursing home benefits, except for prescription drugs and non-routine durable medical equipment.

The government, in its role as employer or former employer, now pays a large share (from 37 percent to 75 percent) of the premium for those benefits, and the annuitant pays the remainder.

If the catastrophic proposals become law,

1. The cost to the FEHBP for these benefits would drop significantly. We estimate a total annual savings of about $100 million in 1989, assuming the benefits in H.R. 2470, or about $70 million, assuming the benefits in S. 1127.

2. Of the total $100 million savings, approximately $60 million would be a savings to the Office of Personnel Management (OPM), and the other $40 million would result in some reduction in premiums paid by FEHBP subscribers. Such a premium reduction, however, would benefit all subscribers in the affected Plans, not just the Medicare eligible subscribers.

3. The total cost to the Medicare eligible annuitants for health insurance would rise substantially without any compensating increase in benefits. In the aggregate, the additional cost to these annuitants would probably exceed $100 million in 1989, due both to the proposed progressive financing structure and to the fact that retired government workers would pay a higher income-related premium based on taxable income, than would other retirees who receive a larger portion of their retirement income from Social Security benefits which are nontaxable.

4. Thus nearly everyone in the FEHBP -- the government, as an employer, and most employees and annuitants -- would benefit from the catastrophic proposals except the people they were designed to assist: the Medicare eligible annuitants.

5. The Medicare eligible annuitants may therefore want to exercise whatever other choices they have. They could:

   a. change FEHBP carriers or options to get the cheapest one available, or
   b. drop out of the FEHBP, or
   c. drop out of Medicare, (Part B).

None of these choices is a satisfactory solution for the Medicare eligible annuitants. Whichever choice they made, they would lose either benefits or money or both.

Short-Run Solutions

What can be done? One approach is to change the treatment of government workers' retirement income, so that their income is no more taxable than it would be if it consisted mostly of Social Security payments. The purpose would be to at least put retired government workers (federal, state and local) on a footing equal to retirees in other sectors of the economy. As a matter of equity, this seems to us an important first step. It would reduce the extra tax burden on the annuitants, though they would still pay twice for the same catastrophic benefits if they remained in the FEHBP. Thus this would be only a partial solution.

A second approach would be to try to return to the Medicare eligible subscribers the actuarial equivalent of the new catastrophic benefits, either in the form of additional benefits or cash refunds. Though these ideas appear reasonable they are not very feasible. Providing enhanced benefits, at this level of actuarial value, would probably provide more benefits than the annuitants want or would like to pay for. Their benefits are already quite comprehensive. (One exception to this conclusion is that a long term care benefit might be designed, as an additional value for these beneficiaries. We are giving serious thought to this idea, possibly extended to all annuitants, and it may be feasible for the long run. For the short run, however, the potential cost and complexity of offering such a benefit nationwide are too great.)

The idea of a refund also has a number of drawbacks: (a) we do not know who all the Medicare eligibles are, at least until they've filed a claim, (b) the mechanics of refunds for one segment of federal subscribers are time consuming and expensive, as we learned two years ago, (c) the refund would have to be an annual event, if the subscribers were to be compensated for their continuing increased Medicare obligations. The only reasonable way to handle that would be in the form of reduced premiums, which would set up another pricing structure for Medicare eligibles. Currently, this is not authorized by the law. In addition, it would, over time, separate these beneficiaries more widely from other annuitants who are not so fortunate as to be eligible for Medicare.

Finally, an idea which has been drawing a lot of attention is to authorize a Medicare Supplemental or "Medigap" option for the Medicare eligible annuitants.

At first glance, this idea has much to commend it. If such an option were available, the Medicare eligible annuitants would then be getting no more than what they (and OPM) paid for. Unfortunately, such an option would also raise the premiums for most other subscribers, would probably cause some current plans to close, and would threaten the stability of the entire FEHBP. How could these things happen?

To fully answer that question would require a review of the entire program and its history, which is hard to do in less than several hours. In the few pages that follow, I will try to summarize the key points in such a review.

First, let me telegraph the conclusions of our review of this subject. There are four:

1. The FEHBP has long been in need of structural reform. Some of the program's features have combined to violate a basic principle of insurance, which is to spread risk as widely as possible.

2. Over the last 20 years, Medicare's payments on behalf of some federal annuitants has been one of the factors that has enabled the FEHBP to cope with the fundamental flaws in the program's structure.

3. In order to solve the problem presented by the catastrophic proposals, the relationship between the FEHBP and Medicare will have to change. A change in that relationship, however, without other changes in the total program, could easily be the thread that unravels the fabric of the overall FEHBP.

4. Therefore, we recommend that the subcommittee plan now to hold comprehensive hearings on the total FEHBP, and be prepared, if the catastrophic proposals become law, to propose a set of programmatic changes which will both handle the problem presented by the catastrophic bills and will get the FEHBP on a more solid foundation.

Now let me provide the basis for those conclusions.

The FEHBP and Adverse Selection

The most widely known and most popular feature of the FEHBP is the annual open season opportunity provided to each employee and annuitant. As you know, each year, each participant has the opportunity to change from one carrier or option to any of a wide variety of other carriers or options. Moreover, the number of choices increases each year as new carriers enter the program. The choices confronting the participants vary both by benefits and by prices. Once these annual choices are made, the government pays its share of the premium to the carriers selected; the government's contribution is the same no matter what the health characteristics or health needs of the employees or annuitants who sign up.

We have been tracking the choice behaviors of people who have joined our program, or who have left it, for many years. The dynamics involved in the choices are very complex, but the bottom line is simple to understand. People either make a change in carrier, or stay with their current carrier, to best suit their own needs. In any one year, people who change carriers tend to be younger, healthier employees or annuitants who are not currently utilizing health care services. They do, however, consider their future needs before making a change. Over a number of years, the impact of these behaviors in the aggregate is to concentrate higher risk people in some plans and lower risk people in other plans. The newer plans, or carriers new to the program, tend to attract the lower risks, the older plans tend to retain the higher risks. That phenomenon is usually referred to as "adverse selection" and "favorable selection." It means that a fundamental principle of insurance, to spread the risks as equally and widely as possible, is violated.

Over the long term, any carrier that tries to offer comprehensive benefits, and attracts and retains more than its share of high utilizers, will have to greatly increase the price of its plan, or the affected option, and the affected subscribers will increasingly choose to go elsewhere. People who will stay in one option or one plan for a long time while the price gets higher and higher tend to be the highest utilizers of health care. When high utilizers of care eventually move to some other option or carrier, the cycle will begin again for their new carrier. It is an inherently unstable system.

Let me give an example from our own program. We have approximately the same number of subscribers in our High Option Single plan as we have in our Standard Option Single plan. The populations enrolled in these two options are roughly the same in terms of age, sex, and annuitant status.

We use the same utilization review procedures, the same hospitals and doctors, and the same cost containment programs in both options. The benefits are more comprehensive in the High Option than in the Standard Option but the hospitalization benefits are not greatly different. The difference in utilization, however, is dramatic. The High Option population has twice (200 percent!) the days of hospitalization per year as the Standard Option population.

I would point out that the FEHBP is not unique in suffering from this problem. Not only are some other employers experimenting with this kind of multiple-carrier, multiple-choice program, but the Medicare program faces the same problem in trying to promote the use of Health Maintenance Organizations (HMOs) which will assume the underwriting risk for Medicare enrollees. For each area for the country, Medicare pays essentially a flat price, adjusted only for demographic factors, for each such enrollee. We now know that such demographic adjustments account for less than 10 percent of the legitimate variation in health care utilization among the Medicare population. Therefore, unless any particular HMO attracts a broad range of people from the Medicare population, who will in the aggregate present an average risk, the HMO stands to either make a sizeable profit or "lose its shirt" and be forced to withdraw from the program. The Health Care Financing Administration realizes that this is a problem and is currently searching for ways to cope with it.

Over its 25 year history, by accident or intention, the FEHBP has managed to keep this problem somewhat under control or by periodically raising the government's contribution rate, or by relying on other payers, or by benefiting from unexpected shifts in utilization patterns, or by the fact that many employees and annuitants do not exercise their right to change carriers. This is not the time to review that entire history, but a few points should be made.

Perhaps the key factor in FEHBP's survival thus far is that relatively few employees and annuitants change plans each year. If there were as much changing of carriers or options each year as there could be, the problem would be significantly worse than it is. We have explored the reasons why people do not change carriers or options as often as they could, and the answer is fairly straightforward. Choosing a health insurance plan in this environment, especially if one is anticipating the need for care, is a very complex economic decision having potentially far-reaching consequences. It requires a great deal of individual effort to consider the choices available and make the wisest selection, given the many variables to consider. Not surprisingly, in any one year, most people decide not to make the investment of time and energy required to make such a choice. For most people, most of the time, unless there is a major change in benefits or costs, they will stay put. For the age 65 and over population, where health care needs are so great, this is a particularly difficult set of choices to make.

When I spoke of FEHBP's relying on other payers to help cope with the problem, I was referring primarily to Medicare. Because there are no "Medicare supplemental plans" authorized for federal annuitants, the Medicare-eligible annuitants choose any of the regular offerings from the participating carriers. When they do use health care, however, Medicare is the primary payer. As I indicated earlier, for these subscribers we cover all of the Medicare deductibles and copayments and also provide a number of other benefits which are not now provided by Medicare. Nonetheless, the Medicare eligible beneficiaries who are FEP subscribers effectively carry more than their own weight in the program. This is extremely important for all other subscribers, particularly for all of the annuitants who are not eligible for Medicare. In our programs now, we have several hundred thousand annuitants who are either under the age of 65 and thus not eligible for Medicare, or who are age 65 and over but are not eligible for Medicare because their work history did not allow it.

If the Medicare eligible participants in the FEHBP either dropped out of the program entirely, or switched to a Medicare supplemental option if one were available, or dropped their Medicare coverage, the premiums for many other people would rise. The full effect of adverse selection would then be apparent for all to see. The impact, of course, would vary widely from Plan to Plan. In our High Option plan, for example, the rates would rise substantially, whereas in our Standard Option plan, the rates would not be significantly affected. If one looks only at the numbers or the percentages of Medicare eligible annuitants in those two options, one could not guess what the effect of a Medigap option, for example, would be. Our Standard

Option population has a much higher percentage of Medicare eligibles than High Option, but the impact on High Option would be much greater than in the Standard Option. The overriding issue is selection.

We believe that the committee should be concerned about the adverse selection problem for at least two reasons. First and most importantly, if the problem grows suddenly worse, the affected carriers or options would be in jeopardy, their plans and subscribers could become uninsurable, at least temporarily, and, to say the least, OPM's operations could be severely disrupted.

That sequence of events could occur if some major change in the FEHBP caused a much larger than expected number of subscribers to switch plans during the next open season.

Second, the adverse selection problem, in a competitive environment like FEHBP, can also be described in terms more directly pertinent to this hearing. Annuitants, by and large, are high utilizers of health care. In a competitive environment among carriers, where lower prices are important, annuitants are not usually seen as "desirable" subscribers. They use "too much expensive health care," and thus drive up the premium rates. In the FEHBP, this potential problem has been softened by Medicare. Because many annuitants have Medicare coverage, annuitants as a group are less costly to the FEHBP carriers than they otherwise would be. Without that Medicare coverage, the incentives rise for many carriers to avoid annuitants as far as possible, or at least to work hard, primarily through sophisticated marketing techniques, to enroll no more than their competitors! While this is not a major factor in the adverse selection dynamic, and many carriers, like ourselves, are committed to assuring easy access and good service for all, the potential for some subtle discrimination against annuitants should not be ignored.

Long-Run Solutions

We believe there are several possible approaches to a reform of the FEHBP. We are not at all confident as to which of the possibilities would make the most sense. Before the Congress should attempt such program reform, however, we would recommend that a number of preliminary questions be addressed in some hearings on this subject. These preliminary questions should include the following:

- What is the total cost of the FEHBP to the government (as employer), and to the subscribers? The assumption underlying the program is that the competition promoted by the FEHBP structure will result in lower prices for the same value of benefits. We are not confident that that is in fact the result.

- What is the current nature of the competition among carriers in the FEHBP? In our view, the competition should be on the bases of value of benefits, quality of service, efficiency of administration, and effectiveness of cost containment. In fact, however, most carriers have learned that the best way to succeed in this market is to enroll healthier subscribers. When the focus of competition is on the selection of the enrollees, rather than on the value of the product, the program is not serving its own purposes.

- What is the current size, and the likely future cost of the administrative burden on the Office of Personnel Management? Not only do all the new entrants (carriers/plans) to the program exacerbate the adverse selection problem, they also clearly add to OPM's managerial problems. If the Office of Personnel Management were to provide proportionately as much oversight to every one of the now 500 participating carriers as it does to us (and it should), the staff of the OPM would have to be several times larger than its present size.

- Is the government inadvertently leading the private sector astray by allowing the FEHBP in its current form to continue? Unfortunately, in many sectors of the economy the FEHBP is seen as a "model" to be emulated by others in developing health benefit programs. Employee-choice programs are rapidly developing in other places, and to the extent they incorporate the same features as the FEHBP contains, their long-term future is frankly bleak.

- For the 65 and over annuitants who do not have Medicare coverage, should the government extend Medicare to cover them? At what cost? To whom? With what impact on FEHBP and on Medicare?

- Does the private sector have some different ways of offering health coverage, particularly to retirees, that the government (as employer) might want to consider?

If the Congress fully addresses those questions, and concludes, as we have, that the FEHBP must be reformed, there are essentially four alternatives to consider. (Each of these assumes that the government will continue to want private insurers to underwrite the program.)

1. The FEHBP could become a group insurance program in the more traditional sense. For this purpose, the government could divide itself into any number of groups, for example, by department or agency. For each group, a carrier could be selected through competitive procurement for some reasonable multi-year period. Each such carrier could be required to offer a set of choices to the employees in that group, such as HMOs, preferred provider organizations, traditional fee-for-service, etc. As long as there were only one underwriter per group, and the risk could be spread across all options, the adverse selection problem would be solved. Solving the selection problem in this fashion, however, would reduce the range and number of choices available to the subscribers, and would greatly reduce the number of carriers participating in the program.

2. The current structure of the FEHBP could be retained, if the government contribution were altered to compensate for risk selection. That is, employees and annuitants would still be offered a broad range of

choices, including Medigap options. However, the program would use a pricing structure which more accurately reflects the actuarial value of each of the products being offered. Then, at the end of each open season, the government would evaluate the enrollment in each carrier and would adjust its contribution to the various carriers to reflect the varying degrees of risk. If multiple carrier, employee choice programs are to succeed in the long run, we believe this is the only viable way to do it.

Admittedly, this approach is technically difficult. The necessary "risk adjustment" cannot be based only on utilization experience because that would take away a carrier's incentive to be administratively efficient and programmatically effective in cost containment. On the other hand, if the government used only demographic factors for the enrollees, such as age, sex, annuitant status, etc., we know that only five to ten percent of the adverse selection problem will be accounted for. Nonetheless, we believe this is a solvable problem. The solution does not have to be perfect to be a major improvement over the current situation.

3. The current program could be made even more competitive, without addressing the adverse selection problem. The law could be amended to allow more carriers, or at least to allow all current carriers, to offer whatever options they want. Currently, we are restricted to offering only two options, but would like to be able to offer additional options such as an option designed only for annuitants, or a

very low-cost economy option, or possibly a Medicare supplemental option. If we had that flexibility, we believe that we and other carriers could cope with the selection problem. The obvious problems with going in this direction are that it makes the employees' choice problem even more complex, it compounds the administrative problem faced by the OPM, and some subscribers such as annuitants, who are less willing to change plans, will pay higher and higher premiums.

4. Taking the pro-competitive logic to its ultimate end, the government could offer vouchers for every beneficiary. There is a "de-regulatory" attractiveness to this option, but its feasibility is very low. A voucher program absolutely would not work without an almost perfect risk adjuster, and that is currently beyond our technical reach.

The subcommittee has also asked for our comments on two proposed amendments to the Medicare catastrophic bill, S. 1127. Our detailed comments on these proposals are contained in our September 9, 1987 letter to the Chairman, a copy of which is attached for the record. In summary, we are concerned that a FEHBP reenrollment option for federal annuitants may, because of adverse selection, result in higher rates for FEHBP subscribers and the government. In addition, for the reasons cited above, we suggest that the proposed study of Medicare supplement options for federal annuitants be broadened to address other alternatives and a comprehensive review of the structures of the FEHBP.

Conclusion

In conclusion, our recommended approach to this problem is twofold. One, revise the income-related premium under the Medicare catastrophic bill to equalize the burden between retired government employees and others, and two, initiate a comprehensive review of the structure of the FEHBP. We believe that the problem posed by the catastrophic insurance proposals is a serious one needing resolution, but not without full consideration of its ramifications. If the Medicare catastrophic problem is the only problem addressed, we fear that the total FEHBP will suffer as a result.

Mr. Chairman, our testimony today raises more questions than it offers answers. The subject is truly challenging, even to those of us who have been working on it for several years. Nonetheless, we are quite optimistic that the FEHBP, with any of several possible modifications, can be put on a solid foundation for the foreseeable future. By and large, the program has served federal employees and annuitants quite well in the past. We would be pleased to assist this subcommittee in any way we can to ensure that the program continues to serve its subscribers well in the future.

Thank you.

1154

Blue Cross
and
Blue Shield
Association

Mary Nell Lehnhard
Vice President

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September 9, 1987

The Honorable David Pryor, Chairman
Subcommittee on Federal Services,
Post Office and Civil Service
Committee on Governmental Affairs
601 Hart Senate Office Building
Washington, DC 20510

Dear Mr. Chairman:

The purpose of this letter is to provide comments on the two amendments concerning federal annuitants that you may offer to the Medicare catastrophic bill, S. 1127. As a health benefits plan that has participated in the Federal Employees Health Benefits Program (FEHBP) since its inception and as the program's largest carrier, we are pleased to provide these comments.

We share your concern about the effects of the Medicare catastrophic bill on federal annuitants who are covered under both Medicare and FEHBP. Most of these individuals and certainly all of those enrolled in the Blue Cross and Blue Shield service benefit plan already have catastrophic insurance through their FEHBP carrier and pay a premium to maintain this coverage. However, if either of the pending Medicare catastrophic bills were enacted, these individuals would be subject to higher Medicare Part B premiums and a new income-related premium, thus resulting in significant increased costs for no gain in insurance protection. Moreover, retired government workers will pay a higher income-related premium based on taxable income than other retirees who receive a portion of their retirement income from Social Security benefits which are nontaxable. We support congressional efforts to help assure that the enactment of a Medicare catastrophic bill does not place an inequitable burden on federal annuitants. We are concerned, however, that the two amendments you are now considering would have unintended negative effects on the stability of the FEHBP.

The first amendment would allow federal annuitants who are currently enrolled in the Medicare program and the FEHBP to drop their FEHBP coverage and reenroll in the program at a later date if the annuitant experiences a reduction in Medicare catastrophic benefits. We believe that this proposal would adversely affect the FEHBP in two ways. First, those annuitants who drop their FEHBP coverage are likely to be reasonably healthy individuals. Less healthy individuals are likely to maintain their FEHBP coverage. This will have the effect of increasing rates in FEHBP since the remaining pool will be in the aggregate, less healthy. Second, once out of the program, those individuals looking to return to the FEHBP are likely to be annuitants

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who are experiencing poor health and believe they need additional health care protection. This future influx of additional less healthy individuals will further weaken the pool and result, again, in an increase in rates for FEHBP subscribers and the federal government.

The second amendment would require the U.S. Office of Personnel Management to conduct a study and report to Congress on the feasibility of providing Medicare supplemental plans as a type of health benefit plan for federal retirees. Allowing FEHBP carriers to offer a new Medicare supplemental policy to retirees with Medicare eligibility would result in higher premiums for others. This is because the Medicare-eligible retirees would drop their existing coverage, which would then become more expensive due to the high costs to the program of retirees who are ineligible for Medicare. We recommend that the amendment not only require OPM to conduct a study of the feasibility of offering Medicare supplemental plans but also identify and analyze other alternatives for providing comprehensive health care coverage to annuitants at a reasonable cost without adversely affecting the FEHBP.

Our recommended approach to this problem is twofold: one, revise the income-related premium under the Medicare catastrophic bill to equalize the burden between retired government employees and others; and two, initiate a comprehensive review of the structure of the FEHBP. While we recognize that this approach is not optimal, we do believe it would avoid disruption in the FEHBP and maintain the basic financing and benefit provisions of the Medicare catastrophic bill.

We are pleased to have the opportunity to provide these comments and would welcome the opportunity to discuss these issues further with you or Mr. Ed Gleiman.

Sincerely,

Mary Nell Lehnhard

1107:cm

cc: Mr. Bill Lawson
Blue Cross and Blue Shield of Arkansas
Mr. Edward Gleiman

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October 29, 1987

The Honorable David Pryor, Chairman
Subcommittee on Federal Services,
Post Office, and Civil Service
Committee on Governmental Affairs
601 Hart Senate Office Building
Washington, DC 20510-6250

Dear Chairman Pryor:

This letter responds to the questions asked by Senator Sasser which were provided to us in your letter of October 20, 1987.

Question: The retired federal annuitant, who has devoted his or her career to serving the public, seems to be placed in a unique position by proposed catastrophic health legislation. It would tie premiums to income, that is, ability to pay, which in principle is quite understandable. But by rendering "taxable" income the benchmark, the House and Senate bills place the annuitant at a disadvantage vis-a-vis his counterpart on Social Security. They may receive the same annual disposable income, but the federal retiree's "looks" larger because it is taxable. And the seeming unfairness is compounded, as I've said and as I've heard here today, because the federal retiree isn't even getting new benefits for this disproportionately large payment. He or she is paying twice for catastrophic coverage.

Is that a fair assessment of the legislation's impact? And am I correct that the federal retiree is unique in this sense? Or do you know of any other categories of eligibles who could voice a similar complaint.

Answer: We believe that Senator Sasser accurately describes the dual adverse effects of the House and Senate catastrophic bills on Medicare-eligible federal annuitants. Under both bills these individuals will pay substantially more than other retirees for coverage they already possess under the Federal Employees Health Benefits program. While federal

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annuitants are the group principally affected, we understand that other retirees whose pension income consists largely of taxable income with little or no contribution from Social Security may be similarly affected. This includes some former state or local government retirees.

We also understand that some private sector retirees, although not required to pay a disproportionately high income-related Medicare premium, would pay for catastrophic coverage they may now receive as a result of comprehensive insurance coverage provided by their former employers.

Question: Suppose the legislation is amended so that the federal annuitant's premium is calculated on the same, or nearly similar basis, as the Social Security recipient's. This wouldn't resolve the whole issue, I know, because the federal worker would still be paying two times for the same thing, but at least not paying nearly so much. Would you comment on the viability of such a change?

Answer: We support an amendment to reduce the income-related premium for Medicare-eligible federal annuitants to a level comparable to that required of other retirees. We recommend this approach as part of an overall strategy to eliminate the unintended negative effects of the catastrophic bill on these annuitants.

Question: Specifically, do you have some idea what proportion of catastrophic health care eligibles are represented by federal annuitants? If as I suspect it is a very small fraction, then would the premium revenues foregone, by treating the federal worker the same as his Social Security counterpart, in any way threaten the integrity of the catastrophic health insurance system?

Answer: Jean Barber, Associate Director for Compensation and Insurance, Office of Personnel Management, testifying on September 23, 1987 before the subcommittee, stated that 760,000 retirees are Medicare-eligible federal annuitants. This represents approximately two percent of the Medicare-eligible population. We believe that reducing the premium liability of these individuals to the level of other Medicare beneficiaries would not threaten the financial integrity of the catastrophic program.

Question: Would it be practicable in your view to exempt federal annuity recipients entirely from the catastrophic health scheme, without forcing them to forego other Medicare benefits they would enjoy? How would this affect the integrity of the system? And again, would this be a complete and equitable solution to a unique problem -- or might other groups claim similar entitlement to an exemption?

Answer: We believe that it would not be feasible to exempt federal annuitants from the catastrophic program while allowing them to maintain other Medicare benefits. Such an approach would be very difficult for the Medicare program to administer. In addition, if this action led to the exemption of other similarly affected individuals and groups, it could fundamentally undermine the financial base of the catastrophic program.

Question: Do you wish to make any other specific suggestion how the pending legislation could be amended, to take account of the issues raised by this hearing regarding federal retirees?

Answer: After the Federal Services, Post Office, and Civil Service Subcommittee hearing on September 23 on this subject, Senator Pryor stated that he would welcome other constructive approaches to solve the problems posed by the catastrophic bill. We responded to the Senator's invitation in a letter to him, dated October 6, 1987. In that letter, we offered an approach which we believe effectively addresses these issues. Our proposal consists of two parts:

- Establish a Medicare Part c program for catastrophic benefits only. Part C would be truly voluntary and those who enroll would pay an income-related premium structured much like those under H.R. 2470 or S. 1127; and
- All Medicare Part B beneficiaries, regardless of whether or not they enrolled in Part C, would pay an additional flat monthly premium approximating the $4 premium increase contained in S. 1127. Revenues from this premium increase would be dedicated to Part C, thus stabilizing the financing base for the voluntary catastrophic program. Mechanisms would be established to discourage beneficiaries from maintaining duplicate coverage.

> This proposal offers several advantages over other discussed alternatives. First, it would eliminate duplicative catastrophic coverage, as well as the disproportionately high income-related premiums for Medicare-eligible federal retirees. Second the proposal would cost no more than the present catastrophic bills, yet would provide the same benefits. Third the proposal is self-funding and would require no new federal spending. Overall, this approach builds on the strengths of the private market yet provides a government safety net for those who are not adequately protected by private insurance.

We hope this information is helpful to the subcommittee in its deliberations on this issue.

Very truly yours,

Alan P. Spielman

Alan P. Spielman
Executive Director
Government Programs Legislation

1225:cm

cc: Mr. Bill Lawson
Arkansas Blue Cross and Blue Shield

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October 6, 1987

The Honorable David H. Pryor
Chairman, Subcommittee on Federal
Services, Post Office and Civil Service
Committee on Governmental Affairs
601 Senate Hart Office Building
Washington, D.C. 20510-6252

Dear Mr. Chairman:

This is in response to your request for potential solutions to the problem that the pending Medicare catastrophic bills pose for federal annuitants who have health care coverage under both Medicare and the FEHBP.

These annuitants, as well as many private sector retirees, would face substantial increases in costs under the proposed progressive financing features of the legislation without any compensating increase in benefits. While the Blue Cross and Blue Shield Association continues to support both H.R. 2470 and S. 1127, we have developed an alternative approach for your consideration. We believe that our alternative would solve this problem yet still achieve the fundamental purpose of the pending legislation, which is to make catastrophic coverage available to all Medicare beneficiaries without placing too heavy a burden on those with low incomes.

Our proposal has two components:

(1) A Medicare Part C would be established for catastrophic benefits only. Part C would be truly voluntary and those who enroll would pay an income-related premium structured much like those under H.R. 2470 or S. 1127; and

(2) All Medicare Part B beneficiaries, regardless of whether or not they enrolled in Part C, would pay an additional flat monthly premium approximating the $4 premium increase contained in S. 1127. Revenues from this premium increase would be dedicated to Part C, thus stabilizing the financing base for the voluntary catastrophic program. Mechanisms would be established to discourage beneficiaries from maintaining duplicate coverage.

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This proposal is conceptually very similar to S. 1127 which finances the voluntary catastrophic benefits through a combination of a flat premium and an income-related premium. The major distinction is that under this proposal beneficiaries could decline catastrophic coverage yet still maintain regular Part B coverage. The beneficiaries opting only for regular Part B coverage would be paying an additional premium to help finance the catastrophic benefits of those who do elect Part C. Since the premium increase would be moderate, we do not believe that most beneficiaries would object to helping assure that a financially sound voluntary catastrophic program will be available to them if they choose to enroll in it and that low income beneficiaries can obtain Medicare catastrophic benefits at an affordable price.

Several witnesses at the hearing you recently held on this issue recommended that the Medicare catastrophic programs be simply made optional for some or all beneficiaries. This approach, however, would defeat the purpose of the catastrophic legislation because as beneficiaries who otherwise would pay the income-related premium dropped out, the catastrophic financing base would be eroded. Either the Federal government would have to subsidize the benefits or low income beneficiaries would have to pay more. These beneficiaries would then face the difficult choice of dropping Medicare Part B entirely (under S. 1127) or becoming impoverished. We believe our proposal avoids this problem, yet answers all of the criticisms of the pending bills that were made by the witnesses.

What are the advantages of this proposal? We believe there are many:

- The program would cost less in total, but provide the same benefits as the pending legislation.
- Medicare catastrophic benefits would not duplicate other coverage, e.g., FEHBP coverage.
- Beneficiaries could avoid the burden of paying an income-related premium that could be as high as $800 in 1988.
- Federal annuitants would not be faced with the difficult choices posed by the pending bills, i.e. dropping Medicare Part B or their FEHBP Coverage.
- The program would be self-financing, requiring no new Federal spending.

- The proposal builds on the strengths of the private market yet provides a government safety net for those who are not adequately protected by private insurance. Establishes a true public/private sector partnership to solve the problem, which was the cornerstone of Secretary Bowen's catastrophic insurance initiative.

- While the precise impact of the proposal on beneficiaries with low incomes will be dependent on the magnitude of the flat Part B premium add-on and how Part C will relate to the Medicaid program, it is unlikely that the proposal would place too heavy a burden on these beneficiaries. If the necessary flat Part B premium add-on was considered too expensive for those with low incomes, the add-on could be increased to raise enough revenues to help States pay the Part B premium for these beneficiaries.

We have not prepared a detailed assessment of the costs and premiums that would be required if the proposal were to become law. However, our preliminary analysis, using the Congressional Budget Offices's (CBO's) estimates of the costs of the benefits contained in H.R. 2470 and S. 1127, suggests that it may be possible to finance a voluntary Part C Medicare catastrophic program in 1989 by a combination of a $3.00 to $4.00 per month increase in the regular Part B premium and an income-related Part C premium. We would be pleased to share with you the assumptions underlying this preliminary estimate. We would, however, strongly recommend that the CBO be asked to prepare a detailed cost estimate, and we would be pleased to assist them in that effort.

Sincerely,

Mary Nell Lehnhard

cc: Bill Lawson
Arkansas Blue Cross and Blue Shield, Inc.

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Medicare Catastrophic Coverage: A Truly Voluntary Approach

Proposal: An optional Part C catastrophic-coverage program would be available to all Medicare Part B enrollees. Part C would be financed from two sources: a monthly flat premium paid by all Part B enrollees, and an income-related premium paid only by Part C enrollees. The new premiums would be structured to be budget neutral (actuarially sound). Mechanisms would be established to discourage beneficiaries from maintaining duplicate coverage.

Advantages

1. Truly voluntary -- individuals would not lose Part B coverage if they declined Medicare catastrophic.

2. The program would cost less in total, but provide the same benefits as the pending legislation.

3. Medicare catastrophic benefits would not duplicate other coverage.

4. The proposal builds on the strengths of the private market yet provides a government safety net for those who are not adequately protected by private insurance. It establishes a true public/private sector partnership to solve the problem, which was the cornerstone of Secretary Bowen's catastrophic insurance initiative.

5. Catastrophic protection would be affordable to all beneficiaries. The Part B premium add-on would subsidize Part C to permit the low income to enroll at no charge or a moderate charge.

6. Beneficiaries who wished to obtain their catastrophic coverage from private group and individual insurance would face only a minimal increase in their Medicare premiums.

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7. Federal and other government retirees would not have to pay the relatively high income-related premiums under the pending bills.

8. The proposal includes the same two financing mechanisms as S. 1127 and H.R. 2470: an add-on to the Part B premium and an income-related premium.

Disadvantages

1. All beneficiaries, not just those who elected Part C, would be contributing in part towards the financing of Part C by an addition (albeit small) to their Part B premium. This means that these individuals will be paying an additional amount for nothing except an option to join Part C.

2. Part C enrollment would be very difficult to predict, making premium estimates uncertain, at least initially.

3. Adds another element of administrative complexity to an already complex program.

4. If Medicaid recipients are not permitted to enroll, would increase Medicaid costs for Part B premium "buy-in" without any offsetting benefits.

Blue Cross and Blue Shield Association
Office of Government Relations
October 1987.

BR:ebs
1183S

STATEMENT OF

CHARLES T. BELL

VICE PRESIDENT, EMPLOYEE BENEFITS DIVISION

AETNA LIFE INSURANCE COMPANY

BEFORE THE

FEDERAL SERVICES, POST OFFICE, AND CIVIL SERVICE SUBCOMMITTEE

COMMITTEE ON GOVERNMENTAL AFFAIRS

UNITED STATES SENATE

SEPTEMBER 23, 1987

Good Morning, I am Charles Bell, Vice-President, Employee Benefits Division, Aetna Life Insurance Company and a Fellow of the Society of Actuaries. Aetna is one of the leading insurance company providers of individual and group life and health insurance. Since 1960 Aetna has administered the Government-Wide Indemnity Benefit Plan offered by the Federal Employees Health Benefits Program (FEHBP). The Indemnity plan is the fourth largest component of FEHBP.

I am pleased to have this opportunity to discuss proposed expansion of the Medicare program and its effect on health benefit plans available to federal retirees. My remarks will attempt to flesh out three general conclusions relative to the interrelationship of expanded Medicare benefits and operation of FEHBP. These are:

1. The proposed expansion of Medicare is questionable with respect to both necessity and focus.

2. Regardless of what happens with Medicare, the legal constraints applicable to FEHBP, which were reasonable in its early years, no longer serve the plan well. We believe that adverse selection, encouraged by current operation of the program, leads to unnecessary excess cost to the federal government measured in tens of millions of dollars annually.

3. If the proposed expansion of Medicare is adopted, modification of FEHBP with respect to Medicare-eligible annuitants becomes an urgent imperative. These annuitants are already paying more than their fair share for coverage which includes coverage of catastrophic expenses. The proposed changes in

Medicare would force them to pay twice for catastrophic coverage with no improvement in benefits.

THE NEED FOR MEDICARE CATASTROPHIC COVERAGE

Medicare beneficiaries' perceived need for supplemental coverage arises from the program's substantial cost-sharing requirements. For inpatient hospital care, Medicare beneficiaries must pay a deductible for each spell of hospitalization, a portion of hospital cost for stays exceeding 60 days and the full cost of inpatient hospital stays that exceed 150 days. For physician, laboratory, and many other medical services, beneficiaries are responsible for 20 percent of the Medicare approved charge plus the full amount of any excess of provider charges over the Medicare allowance. No coverage is provided for outpatient prescription drugs or ancillary coverages, such as dental or vision care.

However, the fact of the matter is that most Medicare beneficiaries, including federal annuitants, already have health plans that effectively supplement Medicare. Nearly 70 percent of Medicare beneficiaries have either individually-purchased "Medigap" coverage or are covered by an employers' retiree health plan. These plans typically provide coverage consistent with or in excess of that proposed in the Medicare expansion. Another 10 percent of beneficiaries with very low income qualify for the Medicaid program.

Thus, about 80 percent of all Medicare beneficiaries already have expanded coverage through other public or private programs. We believe that the remaining minority of beneficiaries currently lacking catastrophic expense coverage could be reached through less sweeping and disruptive measures than those pending before Congress. In this regard, we would urge Congress to focus on providing Medicare supplemental coverage to the relatively small group of poor elderly who have no supplemental coverage, but do not now qualify for Medicaid. Further, we would prefer to work with Congress to develop an appropriate private-public approach to managing the real time bomb in the system, long term care of the chronically ill elderly.

PROPOSED MEDICARE CATASTROPHIC COVERAGE AND THE INDEMNITY PLAN

The FEHBP is a clear example of the duplication and disruption which would be introduced through Medicare catastrophic coverage legislation.

Proposed Medicare catastrophic legislation would limit a beneficiary's liability for most acute medical care costs, at least with respect to Medicare allowable services and charges. Although the House and Senate versions differ in details and approach, in each case they limit the beneficiaries' share of Medicare approved costs to about $1700 per year. However, neither bill would pay for amounts billed by providers in excess of the Medicare approved charge, coverage of prescription drugs would be limited or non-existent and other Medicare exclusions, such as dental, vision and hearing care would remain.

The Indemnity plan's catastrophic coverage is already superior to that proposed by either the House or Senate. For Medicare-eligible annuitants, the plan essentially supplements Medicare coverage to the point where beneficiaries can receive virtually 100% coverage of most medical costs recognized by Medicare. In addition, the plan covers most amounts billed in excess of Medicare allowed charges, as well as prescription drugs and preventive dental care.

For annuitants not enrolled in Medicare, routinely available plan options allow beneficiaries to limit their portion of total expenses for any serious illness to approximately $1700. Once again, this figure includes most provider charges and prescription drugs.

THE EFFECT ON FEDERAL ANNUITANTS OF MEDICARE CATASTROPHIC PROPOSALS

In effect, then, proposed Medicare catastrophic legislation would simply shift payment for certain catastrophic expenses from FEHBP to Medicare. The benefit to Medicare-eligible annuitants would be minimal, if any. Yet their total premium cost would increase dramatically because there is no flexibility in FEHBP to recognize the redundancy. This is clearly not an attractive or equitable financial deal from the point of view of the annuitant.

In addition to the financial implications, there is the more esoteric concern that these proposed changes would have the effect of withdrawing a promised benefit from some federal annuitants. Under current and historical FEHBP provisions, retiring federal employees may have concluded that the continued coverage of these benefits on a subsidized basis through FEHBP was an integral part of their employment relationship with the federal government.

EXPERIENCE UNDER THE GOVERNMENT-WIDE INDEMNITY PLAN

Before addressing potential solutions to the financial dilemma posed by this issue, I would like to point out that it is merely the most visible symptom of the basic structural problems faced by FEHBP in the current environment.

A brief review of financial results for the Indemnity plan brings into sharp focus the already existing problem that Medicare-eligible annuitants are heavily subsidizing both active enrollees and annuitants who are not Medicare-eligible. The Indemnity plan currently covers about 300,000 federal employees and annuitants. Of these, annuitants with Medicare make up the largest single group, currently about 120,000. There are about 60,000 annuitants over age 65 who do not have Medicare and about 30,000 annuitants under age 65. Active federal workers make up the remaining 90,000 Indemnity plan enrollees. (See Table 1)

Under the statute governing FEHBP, all of these groups are required to pay exactly the same premium even though their actual cost profiles are substantially different. Because the Indemnity plan is secondary to Medicare, Medicare-eligibles are the group with the lowest claims costs. As a result, they provide a substantial subsidy to other enrollees. This subsidy also occurs in all other FEHBP plans.

To quantify this for you, we project that in 1988 the average claims cost for a Medicare-eligible annuitant will be less than half that of an annuitant who is not eligible for Medicare, even without the proposed change in Medicare benefits. (See Table 2)

THE EFFECTS OF PLAN SELECTION AVAILABLE TO ANNUITANTS

Each year, all enrollees in FEHBP have the opportunity to change plans and select an option that best meets their benefit needs and cost parameters from among the available choices. Over the years, the necessity to increase premiums for all Indemnity plan participants in order to subsidize the high cost annuitants who are not eligible for Medicare has caused the enrollment profile of the plan to deteriorate markedly. Younger, healthier individuals have migrated to other plans where the subsidy is not required. Those who are older, with established medical and service relationships, tend to remain behind. This further escalates the average cost profile of the Indemnity plan.

Today annuitants comprise approximately 70 percent of total enrollment in the Indemnity plan, compared with 55 percent in 1981. Total enrollment in the Indemnity plan now stands at about 300,000, about 30 percent lower than 1981, when there were about 435,000 enrollees in the plan. Roughly 80 percent of the decline in enrollment in the Indemnity plan has been by younger, healthier, lower cost active employees. For the most part, we believe that the decision to leave the plan has been heavily influenced by relative changes in the premium cost compared with other plans.

This trend has caused a severe financial strain on the Indemnity plan and other similar primary FEHBP plans. As importantly, however, it has created a significant and unintended cost burden on the federal government which, in a perverse way, further aggravates the problem.

In actuarial terms, this problem is called adverse selection. In simple terms, it means that, given the option, each individual will choose the plan which provides the lowest cost or best benefits related to their personal circumstances.

The excess government cost arises because the government contribution toward any plan option under FEHBP is controlled by a dollar amount determined from the average cost of six large plans which include a disproportionately larger number of annuitants. As younger, healthier employees leave the Indemnity and Service benefit plans for one of the more than 400 other plans that do not have large numbers of annuitants and older active employees, the contribution formula drives up the federal subsidy for all plans. This in turn makes the competing plans look that much more attractive to the healthier employees who tend to be primarily motivated by cost, because the federal contribution covers a larger portion of the premium in these lower cost plans.

We believe the excess federal cost introduced due to this phenomenon of adverse selection amounts to tens of millions of dollars annually.

THE NECESSITY OF MODIFYING FEHBP

Returning now to the microcosm of Medicare-eligible annuitants, enactment of a Medicare catastrophic bill will force them to seriously reconsider their continued participation in FEHBP. They will not only be forced to subsidize those who are not eligible for Medicare, they will suffer a substantial increase in total cost with no net gain in benefits. However, for them to choose to drop out of either FEHBP or Medicare would be a substantial sacrifice in benefits and would sharply increase federal government costs. Without modifying FEBBP's underlying structure, neither these annuitants nor the federal government is presented with any attractive or equitable options.

We believe that the appropriate and obvious solution would be to allow carriers more flexibility in setting FEHBP benefits and rates and for the federal contribution to the plans to be restructured. Specifically, we propose that carriers be permitted to establish separate benefit plan options for Medicare-eligible annuitants and to establish premium requirements in three groupings to reflect the true underlying cost and value of benefits. These groupings would be: active employees, annuitants eligible for Medicare, and annuitants not eligible for Medicare.

Such a change would clearly cause some dislocation in cost among different groups. In particular, the nominal premium for annuitants not eligible for Medicare would rise. This emphasizes the need for concurrent restructuring of the federal contribution toward premiums. We suggest that the government contribution be set proportionate to the underlying expected cost for each group. We believe that this can be done in such a way as to not materially change total federal cost and, over the long term, produce lower federal cost than would be incurred without the change.

CONCLUSION

Solving the equity problems highlighted by the possible enactment of Medicare catastrophic coverage will require diligent efforts both by OPM and the carriers that participate in FEHBP. In your efforts to provide equity to Medicare annuitants in response to pending Medicare catastrophic legislation, I hope that you will consider correcting the fundamental problems in the program's current design. My staff and I are eager to cooperate with and assist this Committee to develop viable solutions.

TABLE 1. ESTIMATED 1987 INDEMNITY PLAN ENROLLMENT

Active Employees	90,000
Annuitants below age 65	30,000
Annuitants over age 65 Not Medicare-Eligible	60,000
Annuitants over age 65 Medicare Eligible	120,000
TOTAL ALL ENROLLEES	300,000

TABLE 2. Average Claims Costs in Dollars and Costs for Annuitants with Medicare As A Percent of Other Groups Costs

	1988 Dollars		Medicare Annuitants Average Claims Costs As A Percent of Average for Other Groups of Enrollees	
	Single	Family	Single	Family
Annuitant with Medicare	$1,100	$2,300	100%	100%
Annuitant over age 65 (without Medicare)	2,400	4,500	46%	51%
Annuitant under age 65	2,000	3,500	55%	66%
Active Employee	1,300	2,600	85%	88%
Average Claims Cost	1,500	2,800	73%	82%

Source: Aetna calculation based on 1986 Indemnity Plan Paid Claims Report

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Charles T. Bell
Vice President
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October 14, 1987

The Honorable David Pryor
Chairman, Subcommittee on Federal
Services, Post Office and Civil Service
Committee on Governmental Affairs
U. S. Senate
Washington, D.C 20510-6250

Dear Mr. Chairman:

Thank you for the opportunity to appear before your Committee on September 23, 1987 and present our views on the effects of proposed Medicare catastrophic legislation on FEHBP enrollees. I welcome your request for additional details on our recommendation for restructuring FEHBP premiums and contributions. With the increased pressure to enact Medicare catastrophic legislation this year, there is an urgent imperative to concurrently address the premium structure of FEHBP with emphasis on Medicare-eligible annuitants. In the course of discussing our short- and long-term solutions, I will also provide further comments on your proposed amendments to The Medicare Catastrophic Loss Protection Act of 1987 (S. 1127).

While opposing the amendment to permit federal annuitants to re-enroll in FEHBP at a later date, we urge your Committee to recommend changes in FEHBP that would eliminate any incentive for Medicare annuitants to dis-enroll from the program. In the long-term, this should be accomplished by creating a Medicare supplement option for the 1989 benefit year and by modifying the current forumla for determining the government contribution. In the short term, to limit the adverse consequences of Medicare catastrophic legislation on FEHBP in 1988, the Medicare catastrophic premium for federal annuitants should be reduced and Medicare-eligible annuitants' contributions to FEHBP should be lowered to reflect the value of the new Medicare benefits.

AMENDMENT TO PERMIT FEHBP RE-ENROLLMENT OF ANNUITANTS

Allowing annuitants enrolled in Medicare to leave FEHBP but to re-enroll, if future Medicare benefits were reduced, would be contrary to fundamental insurance principles and, as such, would adversely affect both the annuitants and carriers in FEHBP. This amendment would lead to "adverse selection" which would raise average claims costs and require higher premiums in the future.

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Annuitants likely to re-enroll in FEHBP are those with substantial medical expenses. Annuitants with typical or less than average medical expenses would be substantially less likely to re-enroll.

The adverse selection resulting from such a change would exacerbate the fundamental problem in FEHBP's current structure. Because the federal contribution for all FEHBP enrollees is substantially influenced by the premium for plans favored by annuitants, higher costs from re-enrollment would raise federal outlays for all enrollees in FEHBP, not just the indemnity and service benefit plans.

For these reasons, we oppose the amendment to permit annuitants to re-enroll in FEHBP.

AMENDMENT TO REQUIRE OPM STUDY

We, therefore, strongly encourage adoption of your amendment to the Medicare Catastrophic Loss Prevention Act of 1987 (S. 1127) that would require the Office of Personnel Management to study and report to the Congress on the feasibility and desirability of providing a Medicare supplement plan. The proposed amendment, however, does not go far enough. Time is of the essence, if we are to maintain FEHBP as a viable government program in 1989.

As I indicated in my statement at the hearing, Aetna believes that offering a Medicare supplement policy for federal annuitants would benefit both annuitants and the federal government. Implementing a Medicare supplement option must, however, be accompanied by changes in the federal contribution formula.

OPM must be instructed to conduct and complete the required study according to a timetable that would permit implementation of a Medicare supplement option, along with appropriate related adjustments necessary to the continued integrity of FEHBP, in 1989. Because it is likely that the required study will confirm earlier analyses that recommended creation of a Medicare supplement option, your amendment should provide OPM with sufficient discretion to implement the necessary changes for the 1989 benefit year. The study itself should be designed to provide the basis for implementing a Medicare supplement option, along with all other changes in FEHBP's structure necessary to accommodate such a change, particularly changes in the permanent contribution formula.

The need to restructure contributions within FEHBP simultaneous with implementing a Medicare supplement option arises because Medicare annuitants would no longer subsidize the claims costs of other FEHBP enrollees. Although the currently required FEHBP premium for Medicare annuitants is the same as for all other FEHBP enrollees, the average claims costs for Medicare annuitant is substantially lower than the average for all enrollees. Because Medicare annuitants' premiums exceed the claims costs, premiums required for other enrolles are lower than their claims costs. Thus, Medicare annuitants subsidize other FEHBP enrollees, particularly in plans where they represent a significan portion of total enrollment.

Providing Medicare annuitants with a Medicare supplement option at a lower premium than other enrollees would eliminate this subsidy. As a result, the premium for enrollees remaining in other options would increase to reflect the actual claims costs of the remaining enrollees who do not have Medicare. Enrollees in plans with large numbers of non-Medicare annuitants would be faced with substantially higher contributions. Faced with highe contributions, many would leave plans predominated by high-cost enrollees.

Creating a Medicare supplement option without changing the contribution formula would also cause changes throughout FEHBP that would raise federal outlays for FEHBP. Medicare annuitants are heavily concentrated in two of the six plans used to calculate the federal contribution. The increased premium for enrollees who remain in these plans after Medicare annuitants obtain Medicare supplement coverage would directly increase the federal contribution for all plans.

In my response to your request for additional detail on my suggestion for establishing three separate groups within FEHBP, you will find an illustration based on the Indemnity plan which shows the extent of the current cross-subsidy and demonstrates the need to restructure contributions.

We are eager to cooperate with OPM in the preparing this report and developing regulations implementing a new government/enrollee contribution formula because we feel that a Medicare supplement plan should be developed as rapidly as possible.

CHANGING THE CONTRIBUTION FORMULA

To permit establishment of a Medicare supplement option without increasing federal contributions to FEHBP or substantially raising required enrollee contributions, we urge that you amend to enable OPM to promulgate regulations that would permit changes in the government/enrollee contribution formula.

Title 5 of the United States Code Section 8906, Subsections (a), (b)(1), and (b)(2), which establish the formula for calculating the federal government contribution to FEHBP, should be replaced with a provision that would require OPM, in consultation with FEHBP carriers, to promulgate regulations for determining government and enrollee contributions.

In establishing the new contribution formula, OPM should be instructed to establish enrollee contributions separately for each of three groups of enrollees in FEHBP:

Active Employees,

Annuitants without Medicare, and

Annuitants with Medicare.

The enrollee contribution would be calculated in two steps. First, a basic individual and family enrollee contribution should be established for enrollees in each of these three groups regardless of the plan selected. Next, OPM should make adjustments to the basic contribution to recognize differences in each plan's covered services, reimbursement levels, and the plan's efficiency. The federal government's contribution for each enrollee would be the difference between the plan's premium and the amount paid by the enrollee.

OPM should be required to provide assurances to the Congress that, in the aggregate, federal government outlays for FEHBP would not exceed the levels that would result from application of the existing formula. In plans where the change in the contribution formula alone increases the enrollee's contribution, this increase shall be phased in over three years. In plans where the increase in the enrollee contribution does not exceed 20%, however, plans may choose to implement the increase in one year.

ILLUSTRATION OF RESTRUCTURED FEHBP PREMIUMS AND CONTRIBUTIONS

As I described in my statement, FEHBP premiums and contributions should be calculated separately for annuitants with Medicare, annuitants without Medicare, and active employees. In response to your request, we have developed an example for the Indemnity Plan High Option to illustrate the current cross-subsidization of active employees and non-Medicare annuitants by Medicare annuitants. This example also shows the approach that could be taken to restructuring contributions within the Indemnity plan, if Medicare annuitants were provided with a Medicare supplement plan.

Currently established rates for single coverage in 1988 will result in the following premium and contribution levels:

Government Contribution	$35.77	(37%)
Enrollee Contribution	61.31	(63%)
Total Required Premium	$97.08	100%

The first step in restructuring premiums and contributions would be to calculate the "actuarially appropriate" premium rates for the three recommended rating groups. If the federal contribution continued to be calculated with the current formula, the federal government and individual enrollee contributions would be as follows:

	Medicare-Eligible Annuitants	Non-Medicare Annuitants	Active Enrollees
Government Contribution	$35.77	$35.77	$35.77
Enrollee Contribution	30.63	95.58	59.85
Total Required Premium	$66.40	$131.35	$95.62
(as a percent of current premium)	(68%)	(135%)	(98%)

The substantially higher enrollee contribution that would be required for non-Medicare annuitants clearly emphasizes the need for concurrent restructuring of the federal contribution toward premiums. Non-Medicare annuitants would face a 55 percent increase in their contributions. While it may be reasonable that the higher-cost groups pay more, equity suggests that rate differentials reflect the relative value of available benefits.

Some, but not all, of the higher contribution for non-Medicare annuitants could be offset by redistributing the federal contribution within the Indemnity plan. For example, within the Indemnity plan, the government contribution could be set at the same percentage of the underlying expected cost for each of the three groups as it now represents for the three groups combined, about 37 percent. Recalculating the federal contribution for these three groups in the Indemnity plan would re-distribute the government's contribution in the following manner:

	Medicare-Eligible Annuitants	Non-Medicare Annuitants	Active Enrollees
Government Contribution	$27.47	$48.60	$35.23
Enrollee Contribution	41.93	82.75	60.39
Total Required Premium	$66.40	$131.35	$95.62

Medicare-eligible annuitants would pay about 32 percent less than their current premium, while other annuitants would pay about 35 percent more. Active enrollees would pay about 1.5 percent less. Total federal expenditure would be unchanged.

As I indicated earlier, restructuring premiums and contributions across all plans in the program is necessary in order to correct the underlying problem of adverse selection and to control government cost. Because of data limitations, however, we are unable to complete this example for all plans in the program.

Rating each of the three groups separately but without regard for plan choice would lead to enrollee contributions reflecting the relative value of benefits available, not the experience under the particular plan. The government's contribution to a plan with a high concentration of inherently high cost individuals would increase, but would be offset by reduced government contributions to plans with a lower cost profile. This proposal would not materially affect total government cost nor the total income to the plan since it is merely a redistribution of funds among groups. It would, however, materially improve equity and long term viability of the plan.

AMENDMENT TO MODIFY TREATMENT OF ANNUITANTS' INCOME

During discussions with your Subcommittee's staff, I have become aware of a third amendment being considered to reduce the adverse financial impact of Medicare catastrophic legislation on certain annuitants. This proposal would modify the way that a Medicare beneficiary's income would be considered in calculating the additional Medicare premium. This concept would be helpful in providing immediate relief to Medicare annuitants should the Congress enact S. 1127 and we support it. The approach would not, however, fully remedy the plight of Medicare annuitants within FEHBP.

Another urgent concern of these individuals is the excessive premium required of them under FEHBP. We believe that both aspects of annuitant cost must be addressed in order to avoid serious disruption for FEHBP. Our proposal to reduce Medicare annuitants' contribution to offset the added Medicare catastrophic benefits follows.

TEMPORARY SOLUTION

We suggest that, in addition to the proposed change in the determination of the income related premium for Medicare catastrophic coverage, the required contribution for Medicare annuitants should be reduced by the value of the Medicare catastrophic benefit. This reduction would remain in effect until the Medicare supplement option becomes available. Based on CBO estimates of the cost of the Medicare catastrophic benefits included in H.R. 2470, this change would reduce the Medicare annuitants contribution by about $12 per month.

Specifically, a provision such as the following should be enacted:

> The Office of Personnel Management shall reduce the required contribution of an enrollee in a health benefits plan pursuant to Section 89, Title 5 of the United States Code by an actuarially equivalent amount to the catastrophic benefits (as defined in Section 1839(g)(2)(C)(i) of the Social Security Act), as added by Section 5 of this act provided that the enrollee or spouse is:
>
> (a) eligible for benefits under Part A of Title XVIII of the Social Security Act; and
>
> (b) covered by the insurance program established by Title XVIII of the Social Security Act.

This change, combined with the amendment to modify the calculation of the income-related premium, would provide much needed interim relief to Medicare-eligible annuitants.

Thank you again for the opportunity to comment on these measures being considered by your Committee. Should your have any further questions please contact me or Tom Buchberger on my staff (203-636-6435).

Sincerely,

Charles T. Bell

Charles T. Bell

cc: The Honorable Ted Stevens

STATEMENT OF

ERLING HANSEN

GENERAL COUNSEL

GROUP HEALTH ASSOCIATION OF AMERICA, INC.

Good Morning Mr. Chairman and members of the Subcommittee. I'm Erling Hansen, General Counsel for the Group Health Association of America (GHAA). I am accompanied today by Leslie Rose, Deputy Legislative Director at GHAA.

GHAA is the national trade association for health maintenance organizations (HMOs). We represent approximately 75 percent of the enrollment in the more than 700 HMOs nationwide. As of December 31, 1986, nearly 26 million people were enrolled in HMOs.

HMOs provide a comprehensive range of health services in return for a fixed prepaid premium. HMOs are able to provide high quality, cost effective health care because their unique delivery structure allows them to control utilization, particularly in the area of inpatient care. HMOs reported average utilization of 427 inpatient days per 1,000 versus a national average of 920 days per 1,000 last year excluding Medicare, according to the American Hospital Association.

The Federal Employees Health Benefits Program (FEHBP) is important to many HMOs. For the 1988 contract year, 487 HMOs, known as "comprehensive medical plans" will participate in the program. These HMOs cover nearly 2 million people or 17.9 percent of federal workers, annuitants and their dependents. In 1970, there were only 10 HMOs serving less than 4 percent of federal employees. For the 1988 contract year the average premium for HMOs in FEHBP rose an average 5-10 percent.

We have been asked to testify today on the issue of FEHBP and catastrophic protection legislation. The Office of Personnel Management (OPM) estimates the overall number of Medicare-eligible annuitants enrolled in HMOs at 76,000, which is 10 percent of the 800,000 Medicare-eligible annuitants in the FEHBP. There may be an adverse impact of catastrophic legislation on HMOs, both those which participate in FEHB and those which do not. In addition, there are currently some problems in coordinating or integrating FEHB and Medicare which we think you may be able to address.

All HMOs already provide "catastrophic protection" for their enrollees. These benefits are generally equal to or in excess of the benefits provided in the House and Senate catastrophic bills. Both bills are clearly aimed at limiting out of pocket costs and focus primarily on the hospital inpatient expenditures. Most HMOs provide 365 days of hospitalization, some at no additional charge above the HMO premium; while some may have a copayment. In addition, federally qualified HMOs and many state certified HMOs are restricted in the amount they may charge for a copayment and are prohibited from having deductibles for basic health services. Copayment caps put a lid on out of pocket payments and therefore provide effective catastrophic protection.

The problem for HMOs, assuming enactment of catastrophic legislation, is that most enrollees, including federal employees, will not see an appreciable change in their benefits, but because of the "supplemental premium" based on tax liability, they may pay a good deal more for their health coverage. Although GHAA has raised this issue before, there is a strong Congressional committment to treat all Medicare beneficiaries the same - whether they are enrolled in HMOs or are federal employees or annuitants. We believe that some of the characteristics of an HMO - comprehensive benefits, predictable costs, no claim forms, and often care in one setting, will still serve to draw members.

We support the two amendments to the FEHB Act which you have developed Mr. Chairman. We support your amendment calling for OPM to study the feasibility of Medicare supplemental policies and we also support including such benefit packages as an additional option available to federal employees and annuitants. Consumer choice has always been important to our members and to federal employees. We believe it is essential to preserve choice and promote competition in the FEHBP. Resolving the longstanding problem of inadequate coordination between FEHBP and Medicare assures this.

The integration problem between FEHBP and Medicare stems in large part from the lack of authority in the FEHB Act for OPM to contract with carriers for Medicare supplemental policies. As a result, Medicare eligible federal workers and annuitants must pay a full FEHB premium in addition to paying a full Medicare premium. This is unnecessary and unfair. FEHB carriers, including HMOs, should be permitted the option of offering a Medicare supplemental policy. OPM has received complaints that FEHBP plans receive full premiums in addition to Medicare revenues. Although OPM receives a credit based on anticipated Medicare revenues, this is spread across the entire membership. As the Mercer Report of 1982 noted, the integration of FEHB and Medicare results in excess coverage. Allowing carriers to offer a Medicare supplemental policy would provide for improved, cost effective benefits for Medicare eligibles. It would also permit carriers to treat the appropriate federal workers and annuitants in the same manner they treat Medicare eligibles in the private sector.

We also support in principle your amendment which would remove the penalty now imposed on federal workers and annuitants who disenroll from FEHBP by permitting them to re-enroll under certain circumstances. In 1982, under TEFRA, Congress created a new type of Medicare HMO contract which was compatible with the HMO delivery system. Medicare eligibles may enroll with an HMO and receive a benefit package which is generally richer than the Medicare Part A and B benefits. In addition, the premium charged often "buys out" the Medicare deductibles and copayment requirements. As of June, 1987 there were 157 HMOs with Medicare risk contracts serving nearly 1 million people. Unfortunately, the annuitant who disenrolls to join an HMO is not permitted to re-enroll in the FEHBP. This has been a significant barrier to encouraging Medicare eligible federal employees and annuitants to enroll under a Medicare risk contract. Because the Medicare risk contracts and FEHB do not "interface," FEHB employees and annuitants who are Medicare eligible are not permitted to try an HMO and take advantage of a health benefits option which may offer both broader benefits and a less costly package. We have had informal talks with OPM and HCFA on this issue and understand OPM is developing a proposed regulation which would suspend, but not terminate FEHB enrollment if the employee or annuitant wanted to become a member of an HMO with a Medicare risk contract. We would be happy to work with you, Mr. Chairman, to modify your amendment to help correct this serious problem.

The growing number of federal workers, annuitants and their dependents enrolled in HMOs attests to the acceptance of managed health care as a health benefits option. At the same time, the number of HMOs currently participating in FEHBP demonstrates the importance of the federal population to the HMO industry. While we support the concept of catastrophic protection which HMOs already provide, it is important not to burden Medicare beneficiaries with paying more for a benefits package which will not change appreciably, to disadvantage alternative health care delivery systems or to affect the viability of the FEHBP. At the same time, the impact of catastrophic protection legislation on FEHB brings up other inconsistencies and problems between Medicare and FEHBP which we have outlined. We appreciate the opportunity to discuss the issue and look forward to working with you to develop solutions.

NATIONAL ASSOCIATION OF LETTER CARRIERS
AFL-CIO

VINCENT R. SOMBROTTO
PRESIDENT

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TESTIMONY OF
NATIONAL ASSOCIATION OF LETTER CARRIERS

BEFORE THE SUBCOMMITTEE ON FEDERAL SERVICES, POST OFFICE AND CIVIL SERVICE

CONCERNING

THE IMPACT OF CATASTROPHIC HEALTH LEGISLATION ON THE FEDERAL EMPLOYEE HEALTH BENEFIT PLAN

9/23/87

CONGRESSIONAL TESTIMONY

THANK YOU. MY NAME IS ROBERT W. VINCENZI, DIRECTOR OF THE NATIONAL ASSOCIATION OF LETTER CARRIERS HEALTH BENEFIT PLAN. I HAVE A STATEMENT TO SUBMIT FOR THE RECORD, WHICH I WILL SUMMARIZE.

THE NALC FIRMLY BELIEVES IN CATASTROPHIC HEALTH CARE. SOARING HEALTH COSTS AND THE POTENTIAL IMPOVERISHMENT OF THE ELDERLY ARE GRIEVOUS PROBLEMS. WE BELIEVE SO STRONGLY IN THE NEED FOR CATASTROPHIC HEALTH COVERAGE THAT WE WORKED WITH THE AFL-CIO FOR PASSAGE OF LEGISLATION, AS DID OTHER MEMBERS OF FAIR, THE POSTAL/FEDERAL COALITION.

MR. CHAIRMAN, THESE ARE VERY TIMELY HEARINGS FOR PUBLIC EMPLOYEES -- AND ANYONE ELSE WHO BARGAINS FOR HEALTH BENEFITS. THEY ARE UNDULY HARMED BY THIS BILL. SO THANK YOU FOR THIS HEARING, ESTABLISHING TESTIMONY FOR THE RECORD AND MOVING TOWARD A SOLUTION.

BACKGROUND ON NALC HEALTH PLAN

LET ME EXPLAIN A LITTLE ABOUT OUR PLAN. THE NALC HEALTH BENEFIT PLAN HAS BEEN IN EXISTENCE SINCE 1950, WHEN IT WAS ESTABLISHED TO PROVIDE HEALTH COVERAGE TO ITS MEMBERSHIP. TODAY WE PROCESS IN EXCESS OF 100,000 CLAIMS EACH MONTH, AND PAY OUT APPROXIMATELY $24 MILLION IN MONTHLY BENEFITS.

WE ARE NOT AN INSURANCE COMPANY PER SE, THAT IS WE DO NOT MAKE A PROFIT. ALL PAYMENTS ARE RETURNED AS BENEFITS, MINUS OPERATING COSTS. THEREFORE, THERE IS NOTHING SELF-SERVING ABOUT THIS TESTIMONY. WE ARE HERE TO REPRESENT OUR ENROLLEES, BECAUSE WE KNOW WHAT THEIR NEEDS ARE.

OUR PROGRAM IS BASED ON "CRADLE TO GRAVE" COVERAGE. IN

OTHER WORDS, TWENTY-ONE YEAR OLD LETTER CARRIERS ARE CHARGED THE SAME PREMIUM AMOUNT, AND RECEIVE THE SAME COVERAGE, AS RETIRED LETTER CARRIERS. AS WITH ANY INSURANCE PROGRAM, OUR PREMIUMS ARE BASED ON THE STATISTICAL DATA FOR THIS ENTIRE, DIVERSE POPULATION IN WHICH THE YOUNGER MEMBERS GENERALLY USE FEWER BENEFITS THAN THE OLDER MEMBERS.

IN THE CASE OF ANNUITANTS, OUR COVERAGE CARRIES OUT THE SPIRIT OF THE 1966 FEDERAL EMPLOYEE HEALTH BENEFIT ACT AND MEDICARE: 100% COVERAGE, USING MEDICARE AS A SUPPLEMENT.

INCIDENTALLY, IN 1966 OUR PLAN COORDINATED WITH MEDICARE AS A FULL, 100% COVERAGE PLAN. MANY OTHERS DID NOT. OPM STRONGLY SUPPORTED ALL FEHBP CONTRACTORS TO FOLLOW OUR EXAMPLE, SOMETHING FOR WHICH WE TESTIFIED OFTEN. CONSEQUENTLY, OUR PLAN'S PREMIUMS HAVE REMAINED RELATIVELY CONSTANT, RESPONDING MAINLY TO INFLATION AND HEALTH COSTS INCREASES. IN THE INTERVENING YEARS, ALMOST ALL PLANS NOW MIRROR THE NALC.

IN 1986 THE NALC PLAN PROVIDED ALMOST $1/2 BILLION TO ITS ENROLLEES; THAT SUM WILL BE EXCEEDED IN 1987. OF THAT AMOUNT, WE RETURNED $181 MILLION TO OUR ANNUITANT ENROLLEES, WHO REPRESENT 34% OF THE TOTAL ENROLLED POPULATION. IN MOST CASES, STATISTICS SHOW THAT ANNUITANTS COVERED BY BOTH MEDICARE AND THE NALC PLAN RECEIVE 100% OF COVERED CHARGES.

EFFECTS OF S. 1127

IF ANNUITANTS FIND THAT THEY CAN NOT AFFORD BOTH MEDICARE AND THE NALC PLAN, WE'RE AFRAID THEY'LL OPT FOR THE

CHEAPER -- AND LESS EXTENSIVE -- COVERAGE IN MEDICARE. OUR PLAN CAN NOT AFFORD TO LOSE THAT GROUP OF ENROLLEES, BECAUSE WHEN THAT HAPPENS THE PREMIUMS BECOME VOLATILE. OUR STATISTICS SHOW THAT THE PREMIUMS WOULD SOAR. NOR DO I THINK THE COUNTRY WANTS TO ENLARGE ITS SECTOR OF UNDERCOVERED ELDERLY. IT RUNS CONTRARY TO DECENT HEALTH POLICY, AND MEANS S. 1127 WOULD HAVE THE UNINTENDED NEGATIVE EFFECT OF CREATING MORE PEOPLE WITH LESS COVERAGE. FURTHERMORE, PASSING THE BUCK BACK TO MEDICARE WILL HAVE TWO ADVERSE MONETARY EFFECTS: (1) RAISE THE DOLLARS NEEDED FROM CONGRESS TO COVER THE ELDERLY FEDERAL/POSTAL POPULATION WHO DISCONTINUE FEHBP, AND (2) RAISE THE PREMIUMS ALL PLANS MUST CHARGE THE REMAINING ENROLLEES. THAT ALSO WILL COST THE GOVERNMENT MORE BECAUSE THE GOVERNMENT PROVIDES A 60% COPAYMENT, BASED ON THE AVERAGE OF THE "BIG SIX" PLANS.

WHILE WE BELIEVE IN CATASTROPHIC CARE, WE BELIEVE THAT CONGRESS SHOULD AIM ITS BILL AT THOSE WHO NEED IT. QUITE FRANKLY, S. 1127 WOULD NOT SIGNIFICANTLY HELP RETIRED LETTER CARRIERS -- OR ANY OTHER WORKERS WHO BARGAIN FOR HEALTH BENEFITS. THERE ARE MANY OTHER UNIONS IN A SIMILAR POSITION. WE FIND OURSELVES FACED WITH THE SAME PROBLEM: OUR RETIREES ARE PUT IN THE UNFAIR POSITION OF PAYING A TAX -- WHICH MAY INCREASE DRAMATICALLY IN A SHORT PERIOD OF TIME -- FOR NOTHING.

I SAY "NOTHING" BECAUSE IN MOST CASES S. 1127 AND MEDICARE PARTS A AND B OFFER LESS COVERAGE THAN THE FEDERAL

EMPLOYEE HEALTH PLANS. FOR EXAMPLE, SOMEONE WITH BOTH MEDICARE AND NALC'S PLAN RECEIVES 100% OF DRUG BILLS. SOMEONE WITH JUST MEDICARE WILL HAVE A DEDUCTIBLE OF AT LEAST $500, ACCORDING TO THE CURRENT PROPOSALS. THAT ALSO IS TRUE IN VARYING DEGREES FOR HOSPITAL CARE, HOME VISITS AND OTHER NECESSARY HEALTH CARE ITEMS.

UNDER THE CURRENT SENATE PROPOSAL, AN ANNUITANT EARNING $20,000 WOULD PAY $190.00 FOR NO ADDITIONAL BENEFITS. THAT'S A BAD DEAL BY ANY STANDARDS.

THIS DOUBLE COVERAGE PROBLEM HAS SEVERAL POSSIBLE SOLUTIONS. THROUGH THE CONGRESSIONAL AUTHORIZING COMMITTEES, INSTRUCT OPM TO PROVIDE MINIMUM BENEFIT LEVELS FOR FEDERAL/POSTAL MEDICARE RECIPIENTS, FOR EXAMPLE, NURSING HOME CARE. HAVE FEHBP REMAIN THE PRINCIPAL SOURCE OF PAYMENT. AT THE END OF THE YEAR, THE INDIVIDUAL PROGRAMS WOULD PRESENT OPM A BILL TO COVER THE ADDITIONAL COSTS. MONEY FOR REIMBURSEMENT WOULD COME AS AN ENTITLEMENT FROM THE TREASURY. WHILE THIS SOLUTION WOULD CREATE TEMPORARY MONETARY PROBLEMS FOR US BECAUSE THE ENTITLEMENT WOULD NOT COME UNTIL THE END OF THE YEAR, THE INCREASED COVERAGE WILL KEEP PEOPLE IN FEHBP, WHERE THEY GET THE MOST PROTECTION.

OR, CONGRESS COULD INCREASE ITS COPAYMENT TO RETIREES FROM 60% TO 75% (CURRENTLY, ACTIVE LETTER CARRIERS RECEIVE A 75% COPAYMENT BECAUSE THE USPS ADDS 15% TO THE GOVERNMENT'S SHARE). THIS SOLUTION WOULD HAVE AN UNINTENDED, POSITIVE SIDE EFFECT. MANY POSTAL EMPLOYEES COMPLAIN THAT WHEN THEY RETIRE THEY LOSE THE 15% USPS SHARE AT THE SAME TIME THEIR

TAKE HOME EARNINGS DECREASE. THIS SOLUTION WOULD REMEDY THAT PROBLEM.

ANOTHER SOLUTION WOULD HAVE A YEARLY TREASURY ENTITLEMENT REIMBURSE THE INDIVIDUAL INSURANCE CARRIERS FOR WHATEVER IS INCLUDED IN THE CATASTROPHIC COVERAGE. IN CONJUNCTION WITH OPM, THE ENTITLEMENT WOULD BE EARMARKED TO THE INCREASED HEALTH COVERAGE FOR RETIREES ENROLLED IN THE PLANS. SINCE WE ALREADY NEGOTIATE WITH OPM ON COSTS AND COVERAGE, THIS PROPOSAL WOULD NOT SIGNIFICANTLY CHANGE CURRENT PRACTICE. HOWEVER, IT WOULD ALLOW THE PLANS TO SIGNIFICANTLY INCREASE OTHER IMPORTANT CATASTROPHIC NEEDS, SUCH AS EYEGLASSES, MAMMOGRAMS, AND NURSING HOME CARE.

ANY OF THOSE SOLUTIONS WOULD MEAN THAT PERSONS ELIGIBLE FOR FEHBP, I.E., FEDERAL/POSTAL RETIREES, MEMBERS OF CONGRESS AND THEIR STAFFS AND OTHERS WOULD BE GETTING SOMETHING FOR THE MONEY THEY'RE SPENDING. FURTHERMORE, IT CARRIES OUT THE SPIRIT OF CATASTROPHIC HEALTH INSURANCE, I.E., PROVIDES THE BEST POSSIBLE CARE FOR THE ELDERLY.

IF WE DON'T OFFER A SOLUTION, RETIREES ARE FORCED TO MAKE ONE OF SEVERAL BAD DECISIONS: OPT OUT OF MEDICARE PART B ENTIRELY, EVEN THOUGH THEY MAY HAVE PAID INTO IT AND WILL LOSE SOME BENEFITS (UNDER PRESENT GUIDELINES AND OPM REGULATIONS, PROGRAMS ACCEPT "COORDINATION OF BENEFIT," I.E., IF MEDICARE COVERS IT, THEN WE DO); PAY BOTH MEDICARE AND FEHBP, EVEN THOUGH MEDICARE IS OF MINIMAL VALUE OR OPT OUT OF FEHBP, WHICH PROVIDES THE BEST COVERAGE FOR THEM.

NONE OF THOSE DECISIONS MAKES GOOD FISCAL SENSE FOR THE RETIREE OR GOOD HEALTH SENSE TO A NATION BESET WITH STAGGERING HEALTH PROBLEMS.

IF THE FEHB PLANS SUFFER STAGGERING LOSSES DUE TO ENROLLEES DROPPING OUT, THE ENTIRE NATION WILL PAY. AS I SAID BEFORE, IF WE LOSE A LARGE CHUNK OF OUR POPULATION THE PREMIUMS BECOME VOLATILE -- IN AN UPWARD SPIRAL. ALSO, SINCE FEHB PROGRAMS ARE OFFERED TO BOTH EMPLOYEES AND RETIREES, ANY CHANGE IN GROUP PLAN BENEFITS (E.G., ELIMINATING SOME OF THE MEDICARE COVERAGE) TO COMPENSATE FOR CHANGES IN THE MEDICARE PROGRAM WOULD PENALIZE OTHERS IN THE GROUP PLAN WHO ARE NOT MEDICARE ELIGIBLE.

THIS IS COMPOUNDED BY THE FACT THAT FEHBP ENROLLEES, SHOCKED BY THE COST DEMANDS OF BOTH PLANS, MAY DROP THEIR FEHBP COVERAGE. THEY ARE PROHIBITED BY LAW FROM RE-ENROLLING.

MR. CHAIRMAN, WHILE THE PROBLEM OF DOUBLE COVERAGE IS ACUTE, IT IS NOT AS DRAMATIC AS THE INEQUITY IN THE SIZE OF THE TAX BITE WHICH LETTER CARRIERS WOULD FACE.

THE AVERAGE RETIRED LETTER CARRIER EARNS $14,000 ANNUITY -- WHICH IS FULLY TAXED. AND THEREIN LIES THE PROBLEM. BECAUSE IT IS TAXABLE INCOME, HE OR SHE WOULD PAY AS MUCH AS EIGHT TIMES WHAT A SOCIAL SECURITY RECIPIENT PAYS. THE FIGURES ON OUR RETIRED CARRIERS ARE: $109/YEAR IN SUPPLEMENTAL PREMIUMS FOR UNNECESSARY COVERAGE. HIS NEXT DOOR NEIGHBOR, RECEIVING THE SAME PENSION INCLUDING SOCIAL

SECURITY, WOULD PAY $27/YEAR. IN OTHER WORDS, MEDICARE BENEFICIARIES ALREADY COVERED BY PRIVATE CATASTROPHIC BENEFITS WOULD BE SADDLED WITH SUBSTANTIAL PREMIUM AND TAX INCREASES BUT WOULD GET NO SIGNIFICANT INCREASES IN PROTECTION. THAT IS THE UNFAIRNESS ISSUE IN A NUTSHELL.

THE SIMPLEST SOLUTION WOULD BE TREATING THE ANNUITIES OF FEDERAL AND POSTAL RETIREES THE SAME AS SOCIAL SECURITY. THERE IS A PRECEDENT: IN 1986 CONGRESS RECTIFIED THE UNFAIRNESS OF GRAMM-RUDMAN BY GRANTING OUR RETIREMENT COLA EQUAL STATUS WITH SOCIAL SECURITY COLAS.

MR. CHAIRMAN, $109/YEAR -- OR $9/MONTH -- IS NOT EASY FOR ANYONE ON A FIXED, RETIREMENT INCOME -- PARTICULARLY WHEN INFLATION IS RISING. IT IS AN UNFAIR BURDEN.

ONCE AGAIN, THANK YOU FOR HOLDING THESE HEARINGS. MANY MEMBERS OF CONGRESS HAVE EXPRESSED SYMPATHY WITH OUR PROBLEM, AND ARE SEARCHING FOR A SOLUTION. THE ONLY QUESTION IS HOW DO WE REACH THE SOLUTION?

I WILL BE GLAD TO ANSWER ANY QUESTIONS YOU MAY HAVE.

[illegible]
Lawrence G. Hutchins
Vice President
Richard P. O'Connell
Secretary-Treasurer
Halline Overby
Asst. Secretary-Treasurer
Brian D. Farris
Director, City Delivery
George Davis, Jr.
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October 28, 1987

Honorable James Sasser
298 Senate Russell
Washington, DC 20510

Dear Senator Sasser:

In regard to your questions on catastrophic health coverage, you have raised several points:

Paying Twice for Catastrophic Coverage

Speaking on behalf of the National Association of Letter Carriers Health Benefit Plan, our plan covers every aspect of catastrophic health included in H.R. 2470 and S. 1127. Any federal or postal employee subscribing to our plan has better, more extensive catastrophic coverage than that included in the bills.

Outside the federal government, many unions bargain for health benefits. Some of those benefits cover catastrophic health problems. Hence, Senator Riegle introduced an amendment concerning double-coverage of private sector employees as well as the federal/postal sector.

Treating Federal Annuitants Similar to Social Security

We firmly believe in catastrophic legislation -- for those who need it. We would prefer to be exempt from double coverage, but understand that such an exemption is not forthcoming. But barring such a decision, we believe that we should not be penalized for having catastrophic coverage and being public employees. Our annuitants have the same problems with their health and welfare as they age as social security recipients. I hope that we would be charged at the same rate as retirees with similar incomes.

Proportion of Eligibles in FEHBP

I do not have statistics on what percentage of catastrophic health care eligibles are represented by federal annuitants.

Federal Employee Exemption/Funding

As you state in your letter, federal annuitants probably comprise a very small fraction of the total number of eligible catastrophic health care eligibles. If your assumption is correct, then an exemption would not unduly harm the funding of the program.

Finally, in case you did not have time to read my testimony before your subcommittee, I have enclosed a copy. It has much more detailed, specific answers to the questions you posed.

If I can be of further assistance, please do not hesitate to call.

Sincerely,

Vincent R. Sombrotto

VINCENT R. SOMBROTTO
PRESIDENT

American Postal Workers Union, AFL-CIO
1300 L Street, NW, Washington, DC 20005

STATEMENT OF

THE AMERICAN POSTAL WORKERS UNION, AFL-CIO

before the

Subcommittee on Federal Services, Post Office

and Civil Service

Committee on Governmental Affairs

United States Senate

on

S.1127, Medicare Catastrophic Protection Act of 1987

September 23, 1987

MR. CHAIRMAN, AND MEMBERS OF THE COMMITTEE:

I am Patrick J. Nilan, Legislative and Political Director of the American Postal Workers Union, AFL-CIO. I am here testifying in behalf of our union's President, Moe Biller, and the 335,000 members of the American Postal Workers Union, AFL-CIO, we appreciate this opportunity to appear before the Subcommittee today and present our union's views on S.1127, the Medicare Catastrophic Protection Act of 1987 which is presently pending before the Senate.

Let me say, at the outset, that the American Postal Workers Union understands what has motivated the Congress to propose legislation to improve the insurance benefits provided to this nation's Medicare recipients and to establish mechanisms to examine methods of improving comprehensive health care services to all Americans. We understand and support the effort of the Congress to address the cost of the health services required by this nation's 33 million Medicare eligibles.

There is obviously a crisis in health care in this nation. The cost of health care is escalating beyond the grasp of even the working population in this country, let alone beyond the reach of this nation's retirees. Since 1965, when the Medicare program was established, the Medicare-eligible population's percentage of income which was dedicated to health care will have risen from 15 percent to a projected 18.5 percent by 1991. At the same time, constraints on the Federal budget have resulted in reductions in the Medicare program.

In 1983, the Social Security Act Amendments funnelled a vast new infusion of funds into the Medicare Hospital Insurance (HI) Trust funds, while at the same time, mandating that postal and federal workers pay 1.3 percent of salary into the Trust Fund.

Despite the additional funding provided by the 1983 Amendments, or perhaps because of the additional funding, Congress began to reduce funding for Medicare services in 1986 through a series of proposals which were enacted using the budget process. For the Fiscal Year (1988) which will begin next week, the Congress must again determine to what extent it will reduce Medicare funding as it deliberates budget reconciliation.

It was in this context - the context of fiscal constraint-that led the sponsors of the Medicare Catastrophic Legislation to propose the financing mechanisms which are the subject of this hearing today.

In order to assure that enactment of this legislation does not add to the budget deficits, the proposed legislation is "self-financed," which means that the program beneficiaries will bear the cost of the benefit improvements through two new financing mechanisms.

Under the Senate version of the legislation, S.1127, all Medicare eligible individuals who elect to enroll in the Medicare Part B Supplemental Medical Insurance (SMI) program will be liable for increases in both the regular Part B premium and a new supplemental premium will finance the catastrophic insurance provisions in the legislation.

The House-passed bill, H.R. 2941, also authorizes an increase in the Part B premium, but this increase would not finance catastrophic coverage. Under the House bill, the catastrophic insurance coverage is extended through Part A, the Medicare Hospital Insurance fund, which is mandatory for all Medicare enrollees. Under the House bill the supplemental premium is, therefore, imposed on all Medicare beneficiaries, regardless of whether or not they elect to participate in Part B.

Under both bills, the newly-imposed supplemental premium is calculated using adjusted gross income to determine Medicare beneficiaries' premium liability. Official estimates indicate that the per person premium will equal $580 in 1988 for persons with adjusted gross income of $15,000 or more, and will rise to $1017 for persons at that income level in 1992 - or nearly double in five years.

Because of the tax treatment of income derived from federal annuities, postal and federal retirees will be subject to higher supplemental premiums given that their adjusted gross income levels will be higher than the adjusted gross income levels of Social Security beneficiaries. It was only in 1983 that Congress imposed any measure of tax liability on Social Security beneficiaries, and even that liability is limited to those with incomes exceeding $25,000 and $32,000 for individuals and couples.

Federal pensions are, as the Subcommittee is well aware, are fully taxable from the first dollar and under the legislation would be liable for the increased premium to a greater degree than their Social Security counterparts. As a result, under this proposed legislation, postal and federal retirees who are Medicare eligible will suffer an increased tax liability to finance Medicare catastrophic benefits which their health insurance plans already provide.

Both the House and Senate catastrophic coverage proposal duplicate coverage provided under the Federal Employees Health Benefits program, and for which active and retired postal and federal pay through their FEHB premium.

The American Postal Workers Union Health Benefits Program currently has over 20,000 participants who are Medicare eligible. Under this proposed legislation, these 20,000 families will be assessed what is, in our view, an astronomical and wholly indefensible tax increase to pay for the catastrophic insurance benefits for the general Medicare population.

When we analyzed and compared the benefits provided under S.1127 with the benefits provided currently to our Medicare-eligible health plan enrollees we found that there are few, if any, instances where the proposed legislation authorizes superior coverage.

Given that the premiums and coverage established by this legislation will be imposed mandatorily on most Medicare eligibles, including those enrolled in the American Postal Workers Union Health Benefits Plan, our retired members will be faced with untenable options if this legislation is enacted. Either they must bear the burden of paying both their FEHB premium and the supplemental catastrophic premium or they will be forced, for economic considerations, to abandon their union's sponsored health insurance program for a government-sponsored program with inferior benefits. That election, once made, is irrevocable.

Mr. Chairman, we are not here to argue the merits of catastrophic insurance legislation and whether or not this legislation is good public policy. We are here to express APWU's opposition to the method of financing this legislation which imposes and inequitable, additional tax burden on our retired membership and on all active workers who were forced into the Medicare and Social Security programs by Congressional action in 1983.

We believe that the most equitable solution to the financing problem, which does not impose an additional burden on postal and federal retirees, would be for the Congress or the Office of Personnel Management to establish a separate supplemental premium schedule for postal and federal retirees who are Medicare-eligible. This schedule should recognize the disparate tax treatment of federal pensions which will result in higher supplemental premiums for postal and federal retirees and adjust their premiums downward accordingly. We would be happy to work with the Subcommittee in perfecting our proposal or any proposal which the Subcommittee may have which addresses this issue.

This concludes my statement, Mr. Chairman. I would be happy to respond to any questions which the Subcommittee may have.

AMENDMENT TO SENATE BILL

(APWU Proposed Amendment Language is Underlined)

SEC. 6. SUPPLEMENTAL PREMIUM FOR CATASTROPHIC ILLNESS COVERAGE.

(a) IN GENERAL.--Part B of title XVIII is amended by inserting after section 1839 the following:

"SUPPLEMENTAL PREMIUM FOR INDIVIDUALS COVERED BY PART B

"SEC. 1839A. (a)(1) Any individual described in paragraph (2) shall pay the applicable supplemental premium in the manner provided in subsection (c).

"(2) An individual is described in this paragraph if such individual--

"(A) is covered by the insurance program established under this part for any portion of any taxable year occurring after December 31, 1987, and

"(B) has Federal income tax liability for such taxable year in an amount not less than $150, which does not include federal retirement income;

"(b) For purposes of this section--

"(1) The term 'applicable supplemental premium' means an amount equal to the product of--

"(A) the number of months in the taxable year during which the individual was covered by the insurance program established under this part, multiplied by

"(B) the supplemental premium.

"(2)(A) The term 'supplemental premium' means an amount equal to the product of--

"(i) the premium rate for the taxable year, multiplied by

(ii) the amount determined by dividing--

"(I) For individuals deriving no income from a federal annuity, the individual's Federal income tax liability for such taxable year, by

"(II) $150.

"(iii) or, for individuals whose income is derived in whole or part from a federal annuity,

(I) the individual's Federal Income Tax liability for such taxable year, by

(II) an amount to be determined by the Director of the Office of Personnel Management which makes an equitable adjustment for the differences in tax treatment of social security and federal annuity income.

If any amount determined under clause (ii) is not a whole number, such amount shall be rounded to the next lowest whole number.

(Alternatively, (iii) (II) could read $200.00)

AMENDMENT NEEDED TO S.1127

This amendment to S.1127, the "Medicare Catastrophic Protection Act of 1987" is submitted for the September 23, 1987 hearing before the Subcommittee on Federal Services, Post Office & Civil Service. It is not an exact solution to satisfy the problems which the American Postal Workers Union have concerning inequitable and discriminating impact on retired postal and federal retirees covered by medicare and a Federal Employee Health Benefit plan. Rather, it is a concept which we suggest be considered among other possible solutions to the existing adverse impact on such persons.

Patrick J. Nilan
Director of Legislation
American Postal Workers Union,
AFL-CIO

September 23, 1987

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AMERICAN POSTAL WORKERS UNION, AFL-CIO

RESPONSES TO SENATOR SASSER'S QUESTIONS REGARDING MEDICARE CATASTROPHIC HEALTH INSURANCE.

QUESTION:

The retired Federal annuitant, who has devoted his or her career to serving the public, seems to be placed in a unique position by proposed catastrophic health legislation. It would tie premiums to income, that is, ability to pay, which in principle is quite understandable. But by rendering "taxable" income the benchmark, the House and Senate bills place the annuitant at a disadvantage vis-a-vis his counterpart on social security. They may receive the same annual disposable income, but the Federal retiree's "looks" larger because it is taxable. And the seeming unfairness is compounded, as I've said and as I've heard here today, because the Federal retiree isn't even getting new benefits for this disproportionately large payment. He or she is paying twice for catastrophic coverage.

Is that a fair assessment of the legislation's impact? And am I correct that the Federal retiree is unique in this sense? Or do you know of any other categories of eligibles who could voice a similar complaint?

RESPONSE:

The Senator is correct in his assessment of the impact of the legislation on postal and federal retirees. As currently drafted, both the House and Senate versions of the Medicare Catastrophic Health Insurance legislation will result in postal and federal retirees paying a disproportionately higher premium for the catastrophic insurance coverage provided for in the legislation. This is because the supplemental premium is calculated on adjusted gross income and federal income tax liability and federal pensions are included in the calculation of adjusted gross income, while Social Security benefits are not included until the adjusted gross income of the beneficiary reaches $25,000 (or $32,000 for a couple).

Furthermore, postal and federal retirees are currently eligible for catastrophic health insurance coverage, which is offered (on a mandatory basis) through the Federal Employees Health Benefits Program (FEHBP), and they pay for this coverage through their FEHB premiums. We know of no other group of retirees who, under this legislation, would be required to : (1) pay a supplemental premium which is higher than Social Security recipients and; (2) pay twice for benefits for which they are currently entitled through an employer-sponsored health insurance program.

QUESTION:

Suppose the legislation is amended so that the Federal annuitant's premium is calculated on the same, or a nearly similar basis, as the Social Security recipient's. This wouldn't resolve the whole issue, I know, because the Federal worker would still be paying two times for the same thing, but at least not paying nearly so much. Would you comment on the viability of such a change?

RESPONSE:

We support a new supplemental premium schedule for postal and federal retirees, which takes into account the disparate tax treatment of federal pensions relative to other private pension benefits and Social Security. The APWU has, in fact, proposed an amendment to the Senate bill which would direct the Office of Personnel Management to formulate an equitable premium schedule for civil service annuitants. We would, therefore, support Congressional initiatives in this direction.

QUESTION:

Specifically, do you have some idea what proportion of catastrophic health care eligibles are represented by Federal annuitants? If as I suspect it is a very small fraction, then would the premium revenues foregone, by treating the Federal worker the same as his Social Security counterpart, in any way threaten the integrity of the catastrophic health insurance system?

RESPONSE:

I cannot respond to the Senator's question about the proportion of federal annuitants, overall, who may be eligible for catastrophic health insurance benefits under this legislation. I can tell the Senator, however, that the American Postal Workers Union Health Benefits Plan has 40,300 enrollees in our self and family insurance options who are Medicare-eligibles. (This is the number who pay premiums for our health insurance plan--it does not include dependent spouses who may also be eligible for Medicare). These enrollees represent about 35 percent of our total health plan enrollment.

Using the figures from our own plan, we do no believe that adjusting the supplemental premium for these retirees would jeopardize the financing mechanism in the Catastrophic Health Insurance legislation.

QUESTION:

Would it be practicable in your view to exempt Federal annuity recipients entirely from the catastrophic health scheme, without forcing them to forego other Medicare benefits they would enjoy? How would this affect integrity of the system? And again, would this be a complete and equitable solution to a unique problem--or might other groups claim similar entitlement to an exemption?

RESPONSE:

Given that postal and federal retirees already have access to catastrophic insurance benefits through their Federal Employees Health Benefits Plan, we believe that the most equitable solution for these retirees would be to: (1) exempt them from the legislation's provisions entirely or; (2) allow them the option of purchasing the supplemental catastrophic insurance if they so chose.

While it is true that other groups may claim entitlement to such options, it remains true that no other group shares the unique position of postal and federal annuitants in regard to Medicare coverage.

QUESTION:

Do you wish to make any other specific suggestion how the pending legislation could be amended, to take account of the issues raised by this hearing regarding Federal retirees?

RESPONSE:

On behalf of the members of the American Postal Workers Union, let me take this opportunity to say that the reason this legislation's financing mechanism imposes such inequitable treatment on civil service annuitants is rooted in the fact that Congress has seen fit to treat federal pension benefits differently from other pension benefits. As long as federal pension benefits remain fully taxable, and Social Security and other private pension benefits remain largely exempt from federal taxation, there will be inequities in any legislation where fees and premiums are based on a civil service annuitant's tax liability.

We believe that the ultimate solution to this, and other, legislation's financing inequities would be to put federal pension benefits on the same tax footing as other pension benefits--that is, largely exempted from federal taxation.

Statement of
The Federal Managers Association
on
the impact of proposed health legislation
on the
Federal Employees Health Benefit Program,
before the
Subcommittee on Federal Services, Post Office and Civil Service,
Senate Governmental Affairs Committee

The Federal Managers Association would like to thank the subcommittee for inviting us to speak on the effects of the Catastrophic Healthcare Protection Bill on the Federal Employees Health Benefit Program. We appreciate the Committee's interest in seeking to alter the inequities for public sector employees in the catastrophic plan.

There are two problems with the Senate version of the catastrophic care bill. First, civil service annuitants will pay more than those who are covered by social security at identical income levels for identical insurance. Unfortunately for Federal employees, the supplemental premium to pay for catastrophic coverage is based on the tax code. Most social security is not taxable while civil service annuities are fully taxable. Second, not only are Federal employees paying more for coverage, they are paying more for items already covered under the Federal Employee Health Benefit Program. Federal employees already have catastrophic coverage under FEHBP.

In addition to the hardship placed on our retirees by this proposed legislation, these two inequities could cause serious detriment to the FEHBP program itself. Civil service retirees who leave FEHBP cannot come back into the program. They may choose that option instead of paying for double coverage. There is no telling what will happen to the overall cost of the FEHBP for both the employee and the government if this bill becomes law.

FMA supports the concept of catastrophic healthcare protection but coverage should benefit all in the plan, on an equitable basis. In the bill's present form, FMA would be unable to offer its support for this legislation. The old saying of "you only get what you pay for" applies. We wish that were true. However, Federal employees are paying more and getting less.

In closing, we are asking Congress to modify the premium formula so that public sector annuitants do not pay more than other annuitants in the same income category for the same benefits. We feel Congress should coordinate the FEHBP program with Medicare's expanded catastrophic benefits so the benefits are not duplicated and not paid twice by public sector retirees. The easiest answer to this dilemma, of course, is to pass a bill similar to Rep. Vento's (D-MN) bill, H.R. 1938. This bill would treat public sector retirees in the same manner as private sector retirees for purposes of taxation.

There is no easy solution to the problem created by this new catastrophic protection legislation. But we will do everything we can to help you find a solution.

Thank you for giving us the opportunity to speak before the Subcommittee and I'd be happy to answer any questions.

TESTIMONY
OF
LARRY WALIGORA
MANAGER OF
NATIONAL RURAL LETTER CARRIERS' ASSOCIATION
HEALTH BENEFIT PLAN
ON MEDICARE CATASTROPHIC PROTECTION ACT OF 1987
TO THE
FEDERAL SERVICES, POST OFFICE, AND CIVIL SERVICE SUBCOMMITTEE
OF THE SENATE GOVERNMENTAL AFFAIRS COMMITTEE
SEPTEMBER 23, 1987

Dear Mr. Chairman and Members of the Committee:

It is a pleasure to join you today and share with you our concerns about a piece of legislation that is moving very rapidly through the legislative process, the Medicare Catastrophic Protection Act of 1987, and the adverse effects this legislation would have on Federal retirees.

The Congress, through legislation, passed in 1959, the Federal Employees Health Benefit (FEHB) Program. With some fine tuning along the way, it has been an outstanding and overwhelming success as the largest employer sponsored health plan in the world. The Medicare Catastrophic Legislation which we are offering testimony on today would begin to seriously disrupt and dismantle this program which serves some 5 million Federal employees, retirees and surviving spouses, because it would simply offer those individuals identical coverage to that which they already have under the FEHB Program and force them to pay for something from which they will get no benefit. We predict that most Federal retirees will leave the Federal Employee Health Benefits Plan opting, instead, for only Medicare coverage. The proposed legislation would, thus, dramatically change and reduce the size of the universe of enrollees who are participating in the Federal Employee Health Benefits Program.

We also object to the catastrophic premium schedule in the proposed Senate Legislation because it is based on income taxes owed. That creates difficulties since Federal retirees receive a pension from the Civil Service Retirement Trust Fund and all of the money a Rural Carrier annuitant received would be considered taxable income under this legislation. An employee, who retired from the private sector with similar circumstances and length of service, would have a vastly different premium calculation for the same benefits. As an example, the average Civil Servant retiring at 62 years of age draws a monthly annuity of about $14,000 per year all of which would be used for the calculations of the catastrophic premium. Conversely, someone retiring under a private pension plan at age 62 with about $14,000 in retirement income would most likely be receiving $6,000 of the total in Social Security benefits none of which would be utilized in the calculation for setting the premium under this proposed legislation.

Let's examine the double coverage issue. Under our Federal Health Plan for the catastrophic provision to kick in, a member must accrue $1,000 in out-of-pocket expenses. Under the proposed Medicare Catastrophic legislation, a person must accrue $1,700 in out-of-pocket expenses. In the prescription drug area, our Federal plan picks up 100 percent of the cost for prescription medication if our retired member is also covered by Medicare Part B. Under the proposed Medicare legislation, a person must accrue $500 in prescription drug payments before Medicare would cover 80 percent of the cost of medication.

Under the Rural Carrier Plan, we waive the hospital deductible for Medicare eligible people. Under our plan, we waive the major medical deductible for retired members enrolled in Part B, and additionally we pay the two Medicare deductibles, both hospital and medical.

Let's look at the issues of changing the overall composition of the FEHB Plan members and what that would do to the various plans that participate in the program and, likewise, to the Federal Government's share of the cost of the Program. If the legislation being considered today becomes law and contains a premium structure similar to the current proposal with no allowance for the double coverage of Medicare eligible Federal retirees, then it is our prediction that massive numbers of retired enrollees will simply abandon their FEHB Plan and opt instead for Medicare coverage alone. Since Medicare is already the primary payer of medical expenses for these retired members, with the FEHB Plan serving as a so-called Medicare supplement, it would seem reasonably certain that our prophecy will be fulfilled.

This, in turn, will cause a tremendous change in the demographics of each FEHB plan and will result in a tremendous premium increase to remaining enrollees. Thus, in all likelihood, the Government contribution to the program would also increase substantially under the current FEHB funding mechanism. The only enrollees left to support the program would be active employees, those retired but not yet 65 years old and those retired, over age 65, with no Medicare eligibility. It would be a tremendous financial hardship for those plan members comprising the latter two categories to pay the resulting high FEHB Plan premiums.

We think that there are some things that need to be done to remedy the adverse impact of the proposed Medicare catasrophic legislation on Federal retirees. Such remedies are not simple, but, rather complex. First, some relief must be given to Federal retirees in the computation of the Medicare catastrophic premium to bring the cost in line with their private sector counterparts. Secondly, something must be done to eliminate the double coverage that Federal retirees will be forced to pay for under the Medicare Catastrophic Bill. We would like to suggest very strongly that the Senate insist that the Medicare catastrophic coverage be truly voluntary in so far as participation. For example, make the catastrophic coverage a separate and distinct part of the Medicare Program like Parts A (Hospital) and B (Medical) already are. Such a voluntary nature would at least ensure that Federal retirees with FEHB coverage could make an educated decision on what health coverage best suited their individual situations. However, if the Medicare catastrophic coverage remains mandatory as under the House version or is attached to Part B of Medicare as proposed by the Senate, there is no true voluntary choice. So, we would hope that the members of this Subcommittee could strongly urge the Chairman of the

Senate Finance Committee to insist that the voluntary nature of the coverage be retained in conference.

Mr. Chairman and Members of this Committee, we are very grateful that you have willingly taken your time to hold a hearing on these issues which are of vital importance to the members of the National Rural Letter Carriers' Association. Thank you very much. I would be more than happy to answer any questions that you may have.

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Testimony of Members of the Congressional Federal Government Service Task Force

Before the Senate Subcommitteee on Federal Services, Post Office & Civil Service

September 23, 1987

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TESTIMONY OF SENATOR PAUL SARBANES
BEFORE THE SUBCOMMITTEE ON POST OFFICE AND CIVIL SERVICE
OF THE SENATE GOVERNMENTAL AFFAIRS COMMITTEE
SEPTEMBER 23, 1987

Mr. Chairman, although I support S. 1127, the Medicare Catastrophic Loss Prevention Act and believe that catastrophic illness coverage under Medicare is long overdue, I would like to bring to your attention certain inequities in the bill, which in its current form, would impose an unfair burden on Federal employees and retirees.

The bill requires Federal retirees to pay more for catastrophic coverage under Medicare than private sector retirees who receive the same level of retirement income because the Federal annuity, unlike social security benefits, is taxable. We finance catastrophic coverage on the basis of the individual's tax liability. After asking the Federal retiree to pay more for coverage, we must acknowledge that we, in fact, will provide no additional benefit to Federal retirees. The Federal Employee Health Benefit (FEHB) program already provides catastrophic protection that this bill seeks to extend to all Medicare eligible retirees.

For example, under the Senate version of the bill, a civil service retiree with a $14,000 per year annuity would owe $109 per year for the supplemental premium. By the same token, a private sector employee with a $14,000 pension -- from which $6,000 is derived from social security benefits and $8,000 from a private plan -- would pay a supplemental premium of $27 per year. In other words, a federal retiree would end up paying 4 times more than his private sector counterpart with identical retirement income.

Federal retirees suffer another basic disadvantage that private Medicare eligible employees do not face. Because they belong to FEHB plans that also cover active employees and their families, FEHB plans cannot be readily realigned to meet retiree needs without affecting others covered by the group plan who are not Medicare eligible. Private Medicare recipients, in many instances, can drop their medigap policies if Medicare coverage is extended to avoid double coverages. But once a Federal annuitant leaves the FEHBP, he or she cannot re-enroll. In other words, federal retirees, as compared to private sector annuitants, are forced into paying a disproportionately high premium for duplicative catastrophic coverage unless medigap-type coverage is offered under the FEHBP.

I hope that we will take this opportunity to strengthen the FEHB program, which over the past 6 years has become increasingly expensive for employees and retirees. During the past 6 years, while employees and retirees have paid more, they have gotten less in coverage. Unintentionally, the pending legislation offers FEHB another dose of this bad medicine -- and I would remind my colleagues that our once model FEHB program no longer keeps pace with private sector insurance plans. Many private companies and even state and local health insurance programs pay all the required premiums. Federal employees and retirees split the premium burden on a 40%-60% split with the Federal government.

I am sure my colleagues recognize that when we break new ground in the development of landmark legislation, often unintended consequences arise that require us to refine our approach. This is the case in this instance because Medicare and FEHB, while two distinct programs, share many common elements that make them structurally interdependent. I look forward to working with my good friend from Arkansas to ensure that our final product fully supports the intentions of this legislation and the integrity of the Federal Employees Health Benefits Program.

AMERICAN FEDERATION OF GOVERNMENT EMPLOYEES
Affiliated with AFL-CIO
80 F Street, N.W., Washington, D.C. 20001

STATEMENT BY

KENNETH T. BLAYLOCK
NATIONAL PRESIDENT
AMERICAN FEDERATION OF GOVERNMENT EMPLOYEES
(AFL-CIO)

SUBMITTED TO THE

COMMITTEE ON GOVERNMENTAL AFFAIRS
SUBCOMMITTEE ON
FEDERAL SERVICES, POST OFFICE, & CIVIL SERVICE
UNITED STATES SENATE

ON

CATASTROPHIC HEALTH INSURANCE

SEPTEMBER 22, 1987

On behalf of the American Federation of Government Employees and the 700,000 government employees we represent, I am pleased to submit this statement on proposed legislation to provide catastrophic insurance protection for the elderly.

The current proposals for catastrophic insurance protection for the elderly seek to address escalating out-of-pocket health care expenses by the elderly in this country. From 1977 to 1984 such expenses have increased by 138 percent, reaching $30.2 billion. There is a clear need for new legislation if the Federal Government is to fulfill its health care responsibility to America's elderly as established in 1965 with passage of the Medicare program.

Of course, the lack of adequate health care insurance is not limited to the elderly. There are over 35 million American citizens who have no health insurance at all. AFGE hopes this country will soon join the rest of the advanced Western industrialized democracies and adopt a comprehensive National Health Insurance program.

We do not seek in this testimony to address the difficult issues of the structure and adequacy of the benefits in the proposed legislation. However, we do want to address two particular applications of the legislation which directly harm federal retirees.

First, both the House-passed bill (H.R.2470), introduced by Fortney Stark (D-CA), and the pending Senate legislation (S.1127), introduced by Lloyd Bentsen (D-TX), seek to base the new supplemental premium on an individual's tax liability (adjusted gross income) in order to fund the proposed new benefits. This creates a large disparity between retirees with the same income, because of the different tax treatment of that income. In particular, federal retirees, millions of state and local retirees, and retired Congressional employees who are not covered by Social Security would have all of their retirement income taxed while other retirees whose retirement income is based on Social Security would be advantaged by the favorable tax treatment of Social Security. Social Secuirty is not taxed unless the retiree's adjustment gross income, plus on-half of his or her Social Secrirty exceeds $25,000 ($32,000 for a married couple). Even in this case, at a maximum, only one-half the Social Security benefit would be taxed.

The extent of this disparity is shown in table one and table two which compares the supplemental premium for federal employees with no Social Security income and other retirees with a $6,000 Social Security benefit. ($6,000 is roughly the average Social Security benefit.)

As you can see from Table I, under the Senate proposal the supplemental premium for federal employees would range from $61 at $5,000 of Adjusted Gross Income (AGI) to $378 at $25,000 AGI with effective tax rates ranging from 1.2 percent to 1.5 percent.

This compares to other retirees (with a $6,000 Social Security benefit) who would not begin paying a premium until their income (AGI & SS) exceeded $7,000 and at $25,000 would pay only $244. His or her effective tax rate would range from 0 to 1.0 percent.

With an AGI of $8,000, federal retirees would pay a supplemental premium over four times the amount paid by other retirees! At $25,000 AGI, federal retirees would still be paying half again as much as other retirees.

The House proposal is even worse for most government employees. As shown in Table II, federal retirees would pay an annual supplemental premium of $10 at $6,000 AGI, ranging to $580 at $15,000 AGI and above. This translates into a tax rate of 0.2 percent at $6,000 to a high of 4.0 percent at $14,000. The other retirees (with a $6,000 Social Security benefit) would not begin paying until his/her income (AGI plus Social Security) hit $12,000 and would not reach the maximum supplemental premium of $580 until $21,000. There is a massive $420 disparity in premiums between individuals with equal amounts of income in the $13,000 to $14,000 range.

Recognizing this disparity and correcting it are two separate problems. Ideally, one would take an employee's work history in non-covered employement, calculate what this person would have received from Social Security if such employment was covered by Social Security, and exempt that amount of income. Unfortunately, the administrative complexity of this effort would seem to render it unworkable. Alternatively, one could include Social Security payments as part of the base for calculation of the supplemental premium for all participants and adjust the rates and base accordingly. This would, we suspect, be politically impossible. Given these facts we are left with second best solutions.

We can identify three separate approaches for federal retirees, all of them with some drawbacks. (Most of these could be adopted to the other relevant populations such as state and local employees.) One approach would be to define an adjustment factor which could be applied to the calculation of the supplemental premium for individuals whose income is "primarily" derived from federal retirement programs. The adjustment factor could be defined as one minus the ratio of the average Social Security amount divided by the average Civil Service Retirement amount.

The merits of this approach is that it would be relatively easy to calculate and the same exclusion factor could be applied to all individuals who meet the definition. The drawback is that this proposal would be slightly regressive because high income individuals would receive the same proportional adjustment as low income employees whereas they would not have received proportionately as great a Social Security benefit because of the tilt in Social Security benefit structure to low income workers.

In addition, employees who had signigicant non-federal retirement and non-Social Security income (and still met the definition) would be advantaged because the adjustment ratio would apply to that income as well.

On the other hand, employees who did not meet the definition but drew federal retirement would not have any adjustment at all.

Another approach would be to lower the definition of tax liability by any amount equal to the average Social Security amount times .15 or .28 (which ever is the appropriate rate for the individual according to the tax schedule) for retirees deriving their income primarily from federal retirement programs.

This approach has the drawback of being more difficult to calculate and would be more confusing. One would still have the problem of not compensating individuals who receive federal retirement but such retirement is not their "primary" source of income.

This approach would "overcompensate" those who would have received less than the average Social Security amount from their non-Social Security employment and "undercompensate" those who would have received more than the average.

For federal retirees as a whole who in general have a history of higher than average earning, both of these approaches might result in an overall undercompensation as compared to the ideal since both adjustments are based on the average Social Security amount.

Finally, one could leave the definition of the appropriate adjustment to an executive agency, requiring that agency to meet the goal of horizontal equity. The drawback to this approach is that OPM, the relevant executive agency, is, in general, not trusted by government employees.

We urge the Committee to examine these and any other options which the Committee may be able to conceive. Even if a perfect or ideal solution is not achievable for each individual affected, it is important to achieve a basic adjustment which accommodates equitable treatment for CSRS retirees and other affected groups as a whole.

In addition to our concern for equity in funding, the duplication of benefits provides a special problem for CSRS retirees. In the current situation, CSRS retirees can continue their health insurance under the Federal Employee Health Benefit Program when they retire. The benefits in the catastrophic bills under consideration would basically duplicate benefits already existing in FEHB plans. However, once a retiree drops coverage, he or she is not allowed to re-enroll.

FEHB plans are offered to both employees and retirees, so any change in group plan benefits to compensate for the proposed changes would penalize others in the plan who are not Medicare eligible. Continuing their current FEHB plan and paying even an adjusted supplemental premium would be prohibitively expensive. Yet, retirees would be reluctant to drop their FEHB plan because of the re-enrollment ban.

The Congress could address this concern by revoking the re-enrollment ban outright or making re-enrollment contingent upon changes in the Medicare program.

Congress should also consider requiring the two government-wide plans to offer a medigap plan for retirees. Care would need to be exercised that neither of these options would upset the premium structure in the remaining FEHB plans.

AFGE strongly urges this Committee to ensure that these two concerns are addressed as the Senate takes up this important piece of legislation.

Thank you.

Table I

SENATE BILL COMPARISON (1988)
(Individuals)

* 1 * Adjusted Gross Income (AGI) or Adjusted Gross Income Plus Social Security (SS) (a)	* 2 * Supplemental Premium (SP) for Federal Retiree (b)	* 3 * SP as % of AGI for CSRS Retiree (2÷1)	* 4 * SP for Other Retirees With $6,000 SS Benefit	* 5 * SP as % of AGI and SS (4÷1)	* 6 * Difference in SP (2-4)	* 7 * Federal Retiree SP as % of Other SP (2÷4)
$ 5,000	$ 61	1.2%	$ 0	0	$ 61	--%
$ 6,000	$ 73	1.2%	$ 0	0	$ 73	--%
$ 7,000	$ 86	1.2%	$ 0	0	$ 86	--%
$ 8,000	$ 98	1.2%	$ 24	.3%	$ 74	437%
$ 9,000	$110	1.2%	$ 37	.4%	$ 73	297%
$10,000	$122	1.2%	$ 49	.5%	$ 73	249%
$11,000	$135	1.2%	$ 61	.5%	$ 74	221%
$12,000	$147	1.2%	$ 73	.6%	$ 74	201%
$13,000	$159	1.2%	$ 86	.6%	$ 73	185%
$14,000	$171	1.2%	$ 98	.7%	$ 73	174%
$15,000	$184	1.2%	$110	.7%	$ 74	167%
$20,000	$266	1.3%	$171	.8%	$ 95	156%
$25,000	$378	1.5%	$244	1.0%	$134	155%

a) Since CSRS and other retirees would use the same standard deduction ($3750) and personal exemption ($1,950), it is simpler to use AGI or AGI plus SS to estimate impact

b) Calculated as 12 x $102 x (AGI x tax rate of .15 or .28)/150

Table II

HOUSE BILL COMPARISON (1988)*
(Individuals)

* 1 * Adjusted Gross Income (AGI) or Adjusted Gross Income Plus Social Security (SS)	* 2 * Supplemental Premium (SP) for Federal Retiree	* 3 * SP as % of AGI for CSRS Retiree (2÷1)	* 4 * SP for Other Retirees With $6,000 SS Benefit	* 5 * SP as % of AGI and SS (4÷1)	* 6 * Difference in SP (2-4)	* 7 * Federal Retiree SP as & of Other SP (2÷4)
$ 5,000	$ 0	0.0%	$ 0	0.0%	$ 0	--
$ 6,000	$ 10	.2%	$ 0	0.0%	$ 10	--
$ 7,000	$ 70	1.0%	$ 0	0.0%	$ 70	--
$ 8,000	$140	1.8%	$ 0	0.0%	$140	--
$ 9,000	$210	2.3%	$ 0	0.0%	$210	--
$10,000	$280	2.8%	$ 0	0.0%	$280	--
$11,000	$350	3.2%	$ 0	0.0%	$350	--
$12,000	$420	3.5%	$ 10	.1%	$410	4200%
$13,000	$490	3.8%	$ 70	.5%	$420	700%
$14,000	$560	4.0%	$140	1.0%	$420	400%
$15,000	$580	3.9%	$210	1.4%	$370	276%
$20,000	$580	2.9%	$560	2.8%	$ 20	104%
$25,000	$580	2.3%	$580	2.3%	$ 0	100%

* Based on July 17 Democratic Study Group Fact Sheet on H.R.2470

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STATEMENT

OF THE

AMERICAN PSYCHIATRIC ASSOCIATION

on

EFFECT OF MEDICARE CATASTROPHIC PROPOSALS on the FEDERAL EMPLOYEES HEALTH BENEFITS PROGRAM

before the

SUBCOMMITTEE ON FEDERAL SERVICES, POST OFFICE
AND CIVIL SERVICE

by

John McGrath, M.D., Chairman
Joint Commission of Government Relations

Wednesday, September 23, 1987
Washington, D.C.

Mr. Chairman, Members of the Subcommittee, I am John McGrath, M.D., a physician in the private practice of psychiatry in Washington, D.C., and the Chairman of the Joint Commission on Government Relations of the American Psychiatric Association, a national medical specialty society representing over 34,000 psychiatrists. We appreciate the opportunity of sharing with you our views on the proposed Medicare catastrophic bills' impact on the Federal annuitants who participate in FEHBP and are also Medicare beneficiaries with particular reference to the mental health benefit.

First, we want to applaud the leadership you have taken and the deep concern expressed by the Members of the Subcommittee regarding available health insurance, (and the costs associated with that coverage), to Federal employees in the event they fall victim to a catastrophic illness, especially if the illness is due to a mental or addictive disorder. We look forward to the opportunity to work towards a reasoned and responsible means of assuring that Federal employees receive all medically necessary care at a cost that does not add further burden to those already targeted as the scapegoat of the Federal government.

To date, over 100,000 Federal workers, their dependents and annuitants have been directly affected by reductions in their FEHBP coverage for the treatment of mental illness. Despite the historic evidence that we have presented previously and the constantly accumulating evidence that the cost of covering mental and nervous illness was stable and predictable and had held at roughly 7.7 percent of all health benefits paid — mental health benefits under FEHBP have been significantly reduced. A number of the plans have, since OPM's initial directive in 1980 and without regard to the later indicia of maintaining the mental health benefit, permitted coverage for such illness in the Federal Employees Health Benefits Program to reach a point that is now much less than that provided in the private sector.

A study conducted by the General Accounting Office in December 1986, entitled, "Comparison of Coverage for Federal and Private Sector Employees," states:

> FEHBP plans have generally curtailed the mental health benefit since 1980, in areas such as the number of days of hospitalization covered, the total benefits paid, and the level of deductibles and coinsurance the enrollee must pay. In 1980, most FEHBP plans (15 of the 18 largest) paid 100 percent of initial mental health expenses for a specified time or to a specified dollar limit. But in 1982, mental health coverage was substantially curtailed. Plans reduced their mental health benefits by (1) covering fewer days of hospitalization, (2) limiting the covered treatment costs, (3) limiting the number of outpatient treatments, (4) raising deductibles, or (5) lowering coinsurance rates. In 1984, OPM asked the plans to restructure the benefit to improve long-term inpatient coverage by adding catastrophic protection. In doing so, the plans further reduced coverage for outpatient care and short-term hospitalizations. Also, in 1984, 12 plans limited their lifetime inpatient mental health coverage to a specified maximum, typically ranging from $50,000 to $75,000. Before this change only four plans had lifetime maximums.

An APA study of FEHBP indicated, in fact, that most of the plans cut mental health benefits by more than 25 percent between 1980 and 1984, with many of the larger plans cutting benefits by 50 percent or more. By contrast, the cuts in the benefits for physical health care were only six or seven percent of the total package. To further illustrate these inequities, in our study we compared the out-of-pocket costs for an employee incurring either $10,000 or

$100,000 in inpatient physical health care expenses in a year to those incurred for inpatient mental health care, under current coverage. In all plans, physical illness is fully protected once a limit (usually $2500) is reached. However, the enrollee incurring $10,000 in mental health costs has to spend $8000 out-of-pocket, and if the expenses are $100,000, the out-of-pocket cost can be as high as $75,000. It is not difficult to imagine the plight of an employee or annuitant who is suddenly faced with this type of expense. Please note, health care discrimination of this sort, against the mentally ill, is not restricted to the FEHBP.

Under the current Medicare program outpatient benefits are restricted to $250 annually after coinsurance and deductibles. Inpatient care in a psychiatric hospital is limited to 190 days per a beneficiary's lifetime. Neither of these provisions have been changed since the inception of the Medicare program in 1965. These discriminatory benefits have a devastating impact on Medicare beneficiaries who need mental health services. For these reasons, both Medicare beneficiaries and those Federal employees and annuitants with FEHBP insurance are greatly at risk of having large out-of-pocket expenses if they or a family member suffers from serious mental illness.

Legislation reforming Medicare to provide catastrophic health insurance is a first step on the legislative journey toward non-discrimination and economic protection for the elderly and chronically mentally ill.

As you know, the House passed catastrophic health insurance bill, contains an expansion of the outpatient mental health benefit. It increases Medicare's coverage of the outpatient psychiatric benefit from $500 (with 50 percent copayment) to $2000 (with 50 percent copayment). In addition, the coverage for outpatient prescription drugs and care in a psychiatric unit of a general hospital for those with mental and addictive disorders would be treated as it is for patients with a physical illness. Thus, such inpatient treatment would be provided in a nondiscriminatory fashion. At the same time S. 1170, while unclear vis a vis the outpatient coverage, is the same in regard to inpatient coverage.

If catastrophic health insurance legislation were to become law, the effect on Federal employees would be startling. The combination of a 31 percent average premium increase, an anticipated cost increase for Medicare coverage related to catastrophic coverage, and the discriminatory tax treatment afforded Federal employees when computing the cost per person of the Senate bill's Medicare part B premium, would force the annuitant to either incur a tremendous financial burden or rely solely on Medicare coverage for the purpose of health insurance.

Catastrophic coverage appears to provide no added benefit to the Federal annuitant for twice the price except, as stated earlier, with respect to coverage for mental and addictive disorders, because coverage in the FEHBP for treatment of mental and addictive disorders has fallen to levels which can only be described as archaic. These proposed changes to Medicare provide many Federal annuitants access to coverage that few plans were willing to provide in the FEHBP. Of all the FEHBP plans only one, Blue Cross/Blue Shield high option, provides significant outpatient benefits, (50 visits with 30% copayment in 1987). Mental health catastrophic inpatient coverage now has a trigger ranging from $5000 to $8000 per plan, coupled with their lifetime limits of $50,000 to

$75,000. The need of the annuitant requiring acute care for chronic disabling diseases, such as schizophrenia or severe depression, who is totally reliant on the FEHBP for mental health coverage should not, and can not, be overlooked when discussing the issue of double coverage of catastrophic health care for Federal employees.

Perhaps the only constructive thing to result from this dilemma is that attention is being directed to the FEHBP and its impact on the welfare of the Federal employee. When Congress enacted the Social Security Amendments of 1983, the Federal employees became a contributor to the Social Security Trust Fund for the first time. Congress was faced with a dilemma. Should the government require a full social Security contribution and a full contribution to the Civil Service Retirement System from its employees, or should some reasonable combination of the two systems be implemented thereby establishing an affordable retirement system providing a substantial return on one's investment? Certainly, at no time would Members of Congress, or employees of the Federal government have settled for an outcome which required payment to both CSRS and Social Security yet only offered a return on one or the other upon retirement. Perhaps it is time to re-evaluate the FEHBP in an effort to coordinate Medicare and FEHBP coverage.

In the event Catastrophic Health Insurance proposals become law, we propose that an offset plan be explored. As the Blue Cross and Blue Shield Association testified before you on the effect of Medicare catastrophic proposals on the Federal Employees Health Benefits Program: "The FEHBP has long been in need of structural reform. Some of the program's features have combined to violate a basic principle of insurance, which is to spread risk as widely as possible."

It could be possible for FEHBP carriers to restructure their benefit packages so that catastrophic coverage for annuitants, but not for active employees, is reduced. Such restructing and its concomitant savings would provide carriers the resources to fund active employees' health care coverage where it is currently lacking or insufficient. Minimum levels of coverage could be mandated in order to protect the plan members from drastic reduction in coverage by the FEHBP carrier or by Medicare.

Such a idea can not be considered anything less than a major undertaking that would require a great deal of time and energy. Still at issue is what to do in the interim for those who retire and are forced to make what is in essence, the decision of a lifetime. Whatever the outcome of the debate, whatever interim plan is implemented, of primary importance is the information provided the employee for making his or her decision. When application for retirement is made, employees should be given access to detailed information explaining how their current coverage interacts with Medicare coverage. Only then can the employee reach a conclusion as to which coverage best meets his or her needs. It would be our hope that particular attention would be focused upon the differentials in coverage for mental and addictive disorders and the tragic discrimination that is permitted to exist, contrary to the best interest of the Federal worker and their families in both human and economic terms.

The Federal employee has over the last few years suffered great injustices. Cost of living adjustments have been given only to be taken away, meager pay increases do nothing to alleviate the discrepancies in wages between the Federal and private sectors, and health care benefits erode in value at a speed equal to their rise in costs. Perhaps this latest attack on the Government's workforce can be rewritten into a legislative victory for the federal employee.

STATEMENT OF

THE MUTUAL OF OMAHA COMPANIES

ON

THE IMPACT OF PROPOSED MEDICARE CATASTROPHIC LEGISLATION

ON THE FEDERAL EMPLOYEES HEALTH BENEFIT PROGRAM (FEHBP)

To The

FEDERAL SERVICES, POST OFFICE AND CIVIL SERVICE

SUBCOMMITTEE

of the

COMMITTEE ON GOVERNMENTAL AFFAIRS

UNITED STATES SENATE

September 23, 1987

PREPARED BY:
Robert S. Murphy
Second Vice President
Group Government Contracts

Impact of Medicare Catastrophic Legislation on the Federal Employees Health Benefit Program

On behalf of the Mutual of Omaha Companies, we appreciate this opportunity to present our comments regarding the proposed Medicare Catastrophic legislation and its resulting effect on the Federal Employees Health Benefit Program (FEHBP). Mutual of Omaha is one of the largest providers of individual, family, and group health insurance and has provided health insurance to Federal employees since 1942. We currently underwrite 11 plans in the FEHBP with a combined enrollment of 244,000. Approximately one third of these are retirees.

Most of our comments will focus on the impact of proposed Medicare catastrophic legislation on the FEHBP. The hardships and inconsistencies of double coverage and double premiums, tax inequity and related problems for federal employees under the proposed legislation have been well-covered by witnesses who have testified before the subcommittee, and we support their views. However, we do want to touch briefly on some of those subjects and other issues related to them, especially the competitive advantage now enjoyed by health maintenance organizations (HMOs) in the FEHBP.

We have serious concerns about the two catastrophic health care bills now awaiting action by the Senate (H.R. 2470 & S. 1127). The crux of our concern is that neither of the bills addresses the real catastrophe confronting an increasing number of our "greying Americans".

The catastrophe older Americans fear most is the possibility of facing the enormous cost of long-term health care, in a nursing home or through home health care.

It is a frightening prospect for our senior citizens to spend their twilight years contemplating the total depletion of their financial resources in order to meet such expenses or to become dependent upon others to do so. With the exception of the drug benefit, the type of coverage contained in the pending bills is already available and, indeed, carried by many of our elderly citizens through private insurers. Mutual of Omaha has added these benefits to existing Medicare supplement policies at no charge to the insured.

Long-term care is a different story. We, at Mutual of Omaha, are diligently working on plans that would be within the financial reach of many Americans. For others it will be beyond their reach. It would be a travesty if Congress offers our citizens health care coverage which is already available to them, depleting, in the process, whatever federal monetary resources may be needed for assistance for the true catastrophe facing many senior citizens - long-term care. When Congress squarely addesses that problem, the well of federal funds may be dry.

The potential impact of the Medicare Catastrophic legislation on FEHBP needs to be viewed in the perspective of overall problems that have been developing in FEHBP in recent years. Whether the proposed Medicare Catastrophic legislation is adopted or not, revisions are needed in the FEHBP with particular focus on retirees.

Annuitants and FEHB

We estimate that at least 70% of the annuitants covered by the FEHB plans that we underwrite are eligible for Medicare. Between the coordination of coverage provided by the FEHBP and that currently provided by Medicare, these members receive virtually 100% coverage for their health care expenses. The combined coverage usually extends to prescription drugs. However, since Medicare is the primary payor, it pays a significant portion of the health care services provided to these members. These members are very desirable participants in the health plans since they help keep the costs lower for all of the members in the health plan. Let us review an example from one of our plans.

In 1986, the annual claim cost per member under age 65 was approximately $3,000. With the benefits currently provided by Medicare, the annual claim costs for members age 65 and over was approximately $935. Without the age 65 and over members, all other members of the health plan would need to have their premiums increased by at least 50% in order to cover their own claim costs.

The withdrawal of Medicare beneficiaries from FEHBP plans becomes a major concern when the mandatory provisions of the House Medicare Catastrophic bill are considered. It would be burdensome and costly for Federal retirees to carry both their FEHBP coverage and Medicare. Since they are not allowed to waive Medicare under the current proposals, many of them will drop their FEHB plans. A large withdrawal of Medicare retirees from the FEHBP would have an adverse affect of those remaining. Furthermore, this impact would not fall evenly throughout the FEHBP. The percentage of retirees differs from plan-to-plan. The two plans that have a direct impact on the government's contribution to FEHBP cover approximately 65% of all retirees, i.e., Blue Cross and Aetna.

Adverse Selection and FEHB

The withdrawal of Medicare retirees from FEHBP would worsen problems that have been developing in the FEHBP program over the past few years. These problems are the result of transfers that are being made during open season. In short, those individuals who feel they will need medical care will look for a plan with good benefits and those individuals that do not foresee any immediate medical needs will look for a plan with the lowest cost. As a result, plans with above average benefits have found that they are losing the younger, healthier employees and attracting those with medical needs. The needs of the less desirable members, and the resulting cost, thus are passed on to or assessed against those members who are more desirable i.e. who incur less cost for fewer health requirements. In insurance terminology, this is referred to as "adverse selection". In more simple terms, it means that individuals will make a choice that is in their best interest and detrimental to other participants, and to the plan in general.

Retirees without Medicare coverage will generally have higher expected health needs and therefore seek plans with good benefits. However, the plan they are in will pay out more in benefits than it will receive in premiums without Medicare as the primary payer. The problem would be lessened, to a large degree, if such retirees were evenly distributed throughout the FEHBP. Unfortunately, they are concentrated in a small number of plans as noted above. This inequity could also be lessened if more flexibility were allowed in the premiums for the plans and for the government. In the private insurance industry, there are usually separate classes for active employees, retired employees with Medicare, and retired employees without Medicare. Such a change, in the FEHBP would be a step toward lessening adverse selection and would require a corresponding change in the way the government contribution is determined. That is, a larger government contribution would be needed for those retirees without Medicare.

The Office of Personnel Management, and others, have expressed the need for comprehensive reform of the FEHBP because of problems and inequities in the current program. We support OPM's position in that respect and would point to the preferential treatment of HMOs in comparison to indemnity plans as an example. The significant increase in the number of HMOs admitted to the FEHBP over the past few years has had an impact on adverse selection. While these programs offer more choices to Federal employees, they presently have certain advantages over the traditional plans in FEHBP. For example:

- HMOs most often involve a need for an individual to change providers. This can be a barrier for someone with a long, established relationship with a physician. This is most often going to be the case with a retiree or someone with a history of medical problems. As a result, HMOs have not had to accept an equitable share of retirees without Medicare and other individuals with known medical needs seeking good benefits.

- HMOs in the FEHBP are able to establish their premiums based upon their local area. For those that are in areas where health care costs are below the national average, they have an advantage when competing against traditional plans since these plans must set their rates based on their overall national experience. By the same token, HMOs in the higher cost areas have a more difficult time competing against the traditional plans. Accordingly, the result is that the traditional plans may compete more favorably in the higher cost areas thereby adding an element of selection that increases the cost of the benefits they are underwriting through no real fault of their own.

Some form of area rating would lessen this selection problem to a large degree.

We recognize that changes in the way premiums are set would cause some variations in cost among different plans and among different categories of participants in FEHBP. However, we believe such changes would be in the best interest of the FEHBP in the long run and would "level the playing field" for all of the plans. In this regard, we note that OPM has awarded a contract for a comprehensive evaluation of FEHBP which includes an analysis of Medicare issues. We believe this is a positive step and are prepared to work with OPM in whatever way we can.

Conclusion

We are very pleased that you are holding a hearing on these issues which are of vital importance to the FEHBP. We have serious concerns about the so-called catastrophic health care legislation that passed the House (H.R. 2470) and the bill that is now awaiting action by the Senate (S. 1127). Our concerns are increased by the impact that these bills will have on federal employees who already have catastrophic coverage under the FEHB plans and the disastrous effect they would have on FEHB plans with high ratios of annuitants in their membership. We would urge you, in your considerations, to also focus on what we believe are the fundamental problems in the current program of which the retirees are a part. Toward this end, our Company looks forward to cooperating with this subcommittee to develop workable solutions.

NTEU
The National Treasury Employees Union

STATEMENT OF

ROBERT M. TOBIAS

NATIONAL PRESIDENT

NATIONAL TREASURY EMPLOYEES UNION

TO THE

SUBCOMMITTEE ON FEDERAL SERVICES,

POST OFFICE,AND CIVIL SERVICE

HONORABLE DAVID PRYOR, CHAIRMAN

S.1127, THE MEDICARE CATASTROPHIC HEALTH CARE BILL

U.S. SENATE

WASHINGTON, D.C.

SEPTEMBER 23, 1987

1730 K Street, N.W. • Suite 1101 • Washington, D.C. 20006 • (202) 785-4411

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Mr. Chairman:

Thank you for the opportunity to express the view of the National Treasury Employees Union on S.1127, the Medicare Catastrophic Health Care bill.

NTEU certainly supports the intent of this legislation. We believe that action to provide catastrophic health care for the elderly is long overdue. Most federal insurance plans, in fact, have provided catastrophic coverage for employees and retirees alike for many years, and we feel strongly that this coverage should be available to the Medicare-dependent population.

There are, however, problems in this legislation that are unique to the federal employee. First of all, the bill contains a supplemental premium that is based upon tax liability. Because federal pensions are fully taxable, whereas social security benefits are exempt from taxes up to a certain income level, federal retirees would pay more for catastrophic coverage than their private sector counterparts.

In S.1127, any individual who receives Medicare Part B coverage (which is where the catastrophic coverage would be included), and who has federal tax liability of $150 or more, would be required to pay a supplemental premium based on that tax liability. The premium would be calculated at the rate of $1.02 per month per $150 of federal tax liability, after the first $150.

This formula has a very different effect on federal retirees than on social security recipients. Social Security recipients do not incur tax liability on their pensions unless their total income level is above $25,000 for a single individual, or $32,000 for a married couple. The amount to be taxed is the lesser of one-half of social security benefits for the year, or one-half of excess over the base amount.

A federal annuitant, on the other hand, pays taxes on his or her entire pension, regardless of total income. This means that a federal retiree's entire income would be subject to the formula for the supplemental premium. Under S.1127, a civil service retiree with an annuity of $14,000 per year would be subject to a supplemental premium of $7 per month, or $84 per year. A non-federal retiree with a $14,000 pension, $6,000 of which was social security, and $8,000 of which is from a private plan, would pay a supplemental premium of only $1 per month or $12 per year. The federal retiree winds up paying 7 times more than his social security counterpart with the same income, for the same insurance.

This situation points out, once again, the severe inequities that exist between social security and federal pensions. The best solution to this problem would be the enactment of legislation to treat federal pensions the same as social security for tax purposes. This would be a fair and equitable change in the law. It is simply wrong that those who spend their careers in federal service are put a at disadvantage, as opposed to other retirees, in retirement.

For the purposes of S.1127 an amendment should be adopted that would direct OPM, or another related agency, to calculate a separate supplemental premium for federal and postal retirees, based on the fact that Social Security benefits have different tax treatment than federal benefits.

The premium inequity existing in S.1127 is made even worse by the fact that most federal retirees already receive catastrophic health care coverage through the Federal Employee Health Benefits program. Most of the 440 different plans participating in FEHB provide catastrophic coverage to both employees and retirees. Federal retirees, therefore, if they remain in Medicare Part B, will paying more than any other participants for benefits that are largely duplicative. While many Medicare enrollees could drop their Medigap policies if extended Medicare coverage becomes available, federal annuitants would be afraid to do so, for once a retiree drops out of FEHB, re-enrollment is prohibited.

However, the cost of continuing both Medicare and an FEHB plan would be prohibitive for many retirees, and they might be tempted to drop the more expensive, but more extensive, FEHB. Should this happen, it would have adverse effects on the federal budget. It would substantially increase the amount of money needed to fund Medicare to cover the federal retirees who discontinue FEHB. It would also raise the premiums all plans must charge the remaining participants, employees and retirees alike. This would cost the government because the government provides a 60% co-payment, based on the average of the "Big Six" plans.

It is, therefore, to everyone's advantage to address the problems inherent in this legislation. There are a variety of potential solutions to these problems. FEHB plans, through legislation, could be allowed to provide Medicare Supplemental (Medi-gap) plans for their retirees. Congress could increase the government FEHB co-payment to retirees from 60% to 75%, essentially reimbursing retirees for duplicate coverage. A third solution would have a yearly entitlement reimburse the FEHB carriers for whatever is included in catastrophic coverage. This would end the duplication, and allow the plans to provide additional coverage for the increased money that federal retirees are spending. There are a variety of solutions; the key is to find a way to make this bill equitable for all the elderly.

Once again, thank you, Mr. Chairman, for holding these hearings. I am hopeful that this effort will serve to point out the seriousness of the problems with this legislation, and to provide some potential solutions. Through these efforts, I hope we can find a way to move this important legislation forward in a manner that is fair and equitable to all our retired citizens.

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[From the Federal Diary, Washington Post, Sept. 23, 1987]

DOUBLE BURDEN IN PLAN

(By Mike Causey)

Millions of retired federal, state and local government workers could be rescued from paying double premiums for double catastrophic health insurance protection under a plan in the works in the Senate.

Before the Labor Day recess, the House passed a catastrophic health insurance protection bill. It would be financed by raising Medicare premiums. The House plan also raises premiums for the optional part B of Medicare—which pays doctor bill and covers prescriptions—to about $24 a month, a rise of about 38 percent.

The House bill extends catastrophic health insurance protection to people 65 and older through Medicare. Premiums would be based on the person's taxable income. Since most government and private pensions are taxable, persons who draw most of their income from that source would pay more for coverage than those whose income comes largely from untaxed Social Security benefits.

In addition to paying more, most federal, state and local government retirees have catastrophic health protection as part of government-backed health plans for which they already pay. Insurance premiums under the federal employees-retirees health program are due to go up an average of 31 percent in January.

Hearings begin today on the impact of the catastrophic coverage plan on government retirees before the Senate subcommittee on federal services, post office and civil service. The subcommittee is headed by Sen. David Pryor (D-Ark.).

At a breakfast yesterday, Sen. Lloyd Bentsen (D-Tex.) said, "I think they [government retirees] have a point" in their complaints about the double coverage and double premiums provided under the House plan. Bentsen heads the Senate Finance Committee, which will control the catastrophic health care bill in the Senate.

Ideally, government retirees would like to be exempt from the plan, or have it written so that participation is optional. If not, the plan is to come up with some kind of formula that would somehow reduce their premiums if the catastrophic health coverage bill becomes law.

Congressional Research Service
The Library of Congress

Washington, D.C. 20540

September 29, 1987

TO : Senate Committee on Governmental Affairs
Attention: Denise Boerum

FROM : Janet P. Lundy
Specialist in Social Legislation
Education and Public Welfare Division

SUBJECT : Effect of Proposed Medicare Catastrophic Legislation on Federal Annuitants

As you requested, this memo provides a discussion of the effect of proposed Medicare catastrophic legislation on Federal annuitants. Numerous analysts in the Congressional Research Service helped in the preparation of this memo, including David Koitz, Geoffrey Kollmann, Carolyn Merck, and Raymond Schmitt from the Education and Public Welfare Division; and Gregg Esenwein and Alan Talley from the Economics Division. The memo includes background information on the Medicare program, a summary of the relevant features of the proposed Medicare catastrophic coverage legislation, and two major issues concerning the effect of this proposed legislation on Federal annuitants who are covered by Medicare.

The first issue is that Federal annuitants (and certain other retirees) would pay a larger supplemental premium for the proposed Medicare catastrophic coverage than retirees whose pension income is derived from social security benefits. The tax treatment of the Federal pension (most of which is treated as income subject to taxation) compared to the taxation of social security benefits (which, for the most part, are tax-exempt) means that the Federal annuitant's income and tax liability are larger than that of the private retiree with social security even though they may have the same amount of pension income. Since the proposed supplemental premium is determined according to income (adjusted gross income in H.R. 2470 and tax liability in S. 1127), the Federal annuitant would pay a larger supplemental premium than the private retiree with social security. Several hypothetical examples illustrating these differences in supplemental premiums depending on the type of pension income can be found in appendix 2 of this memo. Medicare-eligible Federal annuitants and other retirees whose pensions are taxed to a greater extent than social security benefits would thus pay a disproportionate share of the cost of Medicare's expanded benefits through their supplemental premium payments.

The second issue concerns the duplication and coordination of benefits between the Medicare program and the Federal Employees Health Benefits (FEHB) program. Since the FEHB program does not offer a Medicare supplemental policy option to its Medicare-eligible Federal annuitants, the FEHB coverage that is currently available to them duplicates Medicare's coverage to some degree. This duplication would be even greater if the Medicare program were expanded to include the proposed catastrophic coverage, and Federal annuitants would be charged a Medicare supplemental premium for duplicative coverage, in addition to the premium they pay for FEHB coverage. Also, because the Medicare program is the primary payer of any medical bills with the FEHB plan paying only any remaining costs according to its policy limits, the Medicare-eligible FEHB annuitant is subsidizing or "overpaying" the cost of the FEHB plan, since he pays that same premium as everyone else in that plan even though Medicare is paying a significant proportion of his medical costs. Thus, under the proposed Medicare catastrophic coverage, Medicare-eligible FEHB annuitants would pay a disproportionate share of the cost of a FEHB plan for benefits that would duplicate Medicare's expanded benefits.

I. BACKGROUND INFORMATION ON THE MEDICARE PROGRAM AND PROPOSED CATASTROPHIC COVERAGE CHANGES

A. The Medicare Program

Medicare is a two-part nationwide health insurance program for 30 million aged and 3 million disabled individuals. Part A of Medicare (the Hospital Insurance program) provides protection against hospital and related institutional costs; individuals reaching age 65 are automatically entitled to Part A benefits if they have worked the required number of quarter-years during which the Medicare payroll tax was deducted from their pay. No premium is charged for Part A coverage. Part B of Medicare (the Supplementary Medical Insurance program) covers physicians' services and other health services such as outpatient hospital services, physical therapy, and diagnostic and x-ray services; almost all persons age 65 and older and all persons covered by Part A of Medicare may voluntarily enroll in Part B, for which they pay a monthly premium ($17.90 per month in 1987).

If a retired Medicare beneficiary is also covered by another insurance plan (e.g., a policy which supplements Medicare's coverage, generally known as a medigap policy, or a plan provided by a former employer, such as under the Federal Employees Health Benefits program), Medicare is the primary payer of any medical bill the beneficiary incurs. This means that the medical bill is first paid by Medicare according to Medicare's coverage and reimbursement rules, and any unpaid portion of the bill is then paid by the other plan according to its coverage and reimbursement rules.

B. Proposed Medicare Catastrophic Coverage Legislation

The 100th Congress is currently considering two bills that would expand current Medicare coverage and provide additional benefits, including a catastrophic limit on beneficiary out-of-pocket costs. These bills are H.R. 2470, which passed the House on July 22, 1987, and S. 1127, which was reported by the Senate Committee on Finance on July 27, 1987. Both bills finance the expanded Medicare coverage in two ways: an increase in the Part B premium and a new income-related supplemental premium that would be collected through the Federal income tax system.

These two bills would apply and calculate the supplemental premium differently. H.R. 2470 requires that all individuals who are eligible for Medicare Part A and who have adjusted gross incomes above a certain amount would pay the supplemental premium. The supplemental premium is determined under H.R. 2470 according to the beneficiary's adjusted gross income. In 1988, if the beneficiary's adjusted gross income is $6,000 or less, no premium would be required. For an adjusted gross income of $6,001 but not over $6,143, the beneficiary would be required to pay an annual supplemental premium of $10. The supplemental premium increases by $10 for every $143 increase in adjusted gross income; the maximum supplemental premium charged in 1988 (for those with adjusted gross incomes over $14,166) would be $580. (See appendix 1 for a table showing the 1988 proposed Medicare catastrophic supplemental premium amounts in H.R. 2470). In future years, the premium amounts would be updated by a Medicare inflation factor, and the adjusted gross income amounts would be adjusted by the cost-of-living adjustment applicable that year to the income tax brackets.

S. 1127 requires that beneficiaries enrolled in Part B pay the supplemental premium. Since Part B is voluntary, beneficiaries could drop their Part B coverage to avoid paying the supplemental premium; however, they would then not be eligible for the catastrophic coverage changes that S. 1127 makes to both Part A and Part B of Medicare. The supplemental premium is determined under S. 1127 according to the Federal income tax liability (taxes owed) of the Medicare beneficiary. In 1988, for those with a tax liability of at least $150, the supplemental premium would be $12.24 per year for each $150 in tax liability; the maximum supplemental premium in 1988 would be $800, which would be reached when a beneficiary's tax liability exceeded $9,750. The monthly supplemental premium rate would be updated in future years according to the percentage change from the previous year in the cost of the catastrophic benefits.

II. EFFECT OF CATASTROPHIC LEGISLATION ON FEDERAL ANNUITANTS: DIFFERENCES IN SUPPLEMENTAL PREMIUM DEPENDING ON TAX TREATMENT OF RETIREMENT INCOME

A. Background Information on Taxation of Various Types of Pension Income

The amount of supplemental premium a Medicare beneficiary would pay will vary under H.R. 2470 and S. 1127 depending on the tax rules applicable in calculating adjusted gross income and tax liability, respectively. These rules treat different types of income differently. For a retiree with pension income, the tax treatment varies depending on the type of pension, as described below.

1. Federal Annuities

The Civil Service Retirement System (CSRS), the largest Federal pension plan and the only major Federal pension plan that does not include social security coverage, requires "after tax" employee contributions toward the plan while the Federal employee is working. In general, under Federal income tax law both prior to and after the Tax Reform Act of 1986 (P.L. 99-514), the pensions of Federal retirees are fully or mostly taxable.

The vast majority of current Federal annuitants retired prior to July 2, 1986, the effective date for the change in the tax treatment of contributory pension plans mandated by the Tax Reform Act of 1986. Under old tax law, retirees were not required to pay taxes on the already-taxed portion of their pension until their accumulated monthly pension amounts equaled the previously taxed contributions they had paid into the retirement system while working. The law restricted this "recovery" period during which the pension was not taxed to the first three years after retirement. Since most current Federal retirees have already recovered their previously-taxed contributions, they must now pay taxes on all of their pension income.

For Federal workers whose annuity starting date is after July 1, 1986, new tax rules mandated by the Tax Reform Act of 1986 apply. For these Federal retirees, most of the pension is taxed except for a small portion that represents a pro rata return of the worker's previously-taxed contributions. The employee-contributed share of a retiree's monthly pension payment is calculated by dividing the employee's pension contributions by the product of the monthly pension times a life expectancy factor; this results in a percentage called the "exclusion percentage." The exclusion percentage is multiplied by the monthly pension to determine the dollar amount of the retiree's monthly pension that is a return of his or her already-taxed contributions; this monthly dollar amount is not taxed. Once the full amount of the previously-taxed contributions is recouped through the untaxed portion of the annuity payments, the monthly annuity is fully taxable. In general, for these Federal CSRS retirees, on average approximately 90 percent of their pension is taxable, and approximately 10 percent (calculated using the exclusion percentage) is untaxed. The average annual CSRS pension in 1986 was $13,566.

Federal employees hired after December 31, 1983, and others who elect to participate, are covered under the new Federal Employees Retirement System (FERS), which has three components. The major component of FERS is social security benefits, which are generally not taxed (see the social security description below). The "basic benefit" component of FERS is taxed similar to the CSRS pension for Federal workers retiring after July 1, 1986. Income from the "thrift plan" component is fully taxable. Currently, only a small number of Federal retirees receive benefits under FERS.

The Federal Employees' Retirement System Act of 1986 (P.L. 99-335) allows retiring Federal employees to elect to withdraw, in one lump sum, their contributions into the retirement system in exchange for a reduced annuity. Most of this lump-sum withdrawal is taxable if received on or after July 2, 1986.

2. Social Security Benefits

Benefits received under the social security system are generally tax-exempt, unless the recipient's adjusted gross income (excluding the yearly social security benefit), plus otherwise tax-exempt interest income, combined with 50 percent of the yearly social security benefit exceeds the following thresholds: $25,000 for individuals, $32,000 for married couples filing joint returns, and zero for married persons filing separate returns. If these thresholds are exceeded, the amount of the yearly social security benefit included in taxable income will be the lesser of (1) one-half of the social security benefit, or (2) one-half of the excess of the following computation over the threshold: the individual's adjusted gross income (excluding the yearly social security benefit), plus otherwise tax-exempt interest income, plus 50 percent of the social security benefit.

Approximately 12 percent of social security recipients are taxed on their social security benefits. The average social security benefit amount for a retired worker in 1987 is $5,890.

3. Private Employer Pensions

Pensions provided by private employers generally do not require employees to contribute. Pensions from such noncontributory plans are subject to taxation when the retiree starts receiving the pension benefit. In those limited cases where "after-tax" employee contributions are made, the taxable portion of the pension benefit is determined using the "exclusion percentage" described above.

4. State and Local Government Pensions

Although there is great variety, most State and local pension plans require employees to make "after-tax" contributions to help finance pension benefits. Therefore, the pensions for these employees are generally taxed except for the employee contribution amount determined by applying the "exclusion percentage" described above. In addition, most State pension plans include social security coverage, whose benefits are generally tax-exempt according to the rules described above.

B. Discussion of the Effect of Medicare Catastrophic Legislation on Federal Annuitants Compared to Retirees With Social Security Benefits

Since the proposed supplemental premium for Medicare catastrophic coverage is based on income as treated by the income tax rules (adjusted gross income in H.R. 2470 and tax liability in S. 1127), the differences in the method of taxation of various retirement income will result in different supplemental premium amounts depending on the retiree's income source. Most pension income is taxable and, for the most part, social security benefits are not. Thus, a Medicare beneficiary whose income is derived primarily from taxable pensions, such as a Federal annuitant, would pay a higher supplemental premium than one whose income is derived from social security benefits. The larger taxable income amount is partially offset for low income retirees who are eligible for the tax credit for the elderly or permanently and totally disabled. This tax credit is more favorable to retirees without social security, since social security benefits reduce the amount of the tax credit. To the extent that this tax credit reduces tax liability, it would reduce the supplemental premium as calculated under S. 1127.

We have developed several hypothetical examples to illustrate the supplemental premiums for Federal annuitants and for private retirees at various annual income levels. The assumptions that have been used in developing these examples are described on the first page of appendix 2. Our examples use a range of income levels including $6,000 (the average social security benefit in 1987); $14,000 (the average Federal pension amount in 1986); $20,000; $30,000; and $50,000. It should be noted that for various income levels between or above the amounts used in our examples, the supplemental premiums will vary accordingly. The table that follows summarizes the Medicare catastrophic supplemental premium amounts calculated in the examples in appendix 2.

1988 PROPOSED MEDICARE CATASTROPHIC SUPPLEMENTAL PREMIUMS BASED ON HYPOTHETICAL INCOME EXAMPLES

H.R. 2470

Annual Income	Supplemental Premium for Federal Annuitant	Supplemental Premium for Private Retiree
$6,000 a/	0	0
$14,000 b/	$470.00	$70.00
$20,000 c/	$580.00	$420.00
$30,000 d/	$580.00	$580.00
$50,000 e/	$580.00	$580.00

S. 1127

Annual Income	Supplemental Premium for Federal Annuitant	Supplemental Premium for Private Retiree
$6,000 a/	0	0
$14,000 b/	$ 48.96 f/	$ 12.24
$20,000 c/	$146.88	$ 73.44
$30,000 d/	$293.76	$183.60
$50,000 e/	$697.68	$709.92

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a/ For the private retiree, assumes income of $6,000 in social security benefits.

b/ For the private retiree, assumes income of $7,000 in social security benefits and $7,000 in taxable pension income.

c/ For the private retiree, assumes income of $8,000 in social security benefits and $12,000 in taxable pension income.

d/ For the private retiree, assumes income of $9,000 in social security benefits and $21,000 in taxable pension income.

e/ For the private retiree, assumes income of $9,000 in social security benefits and $41,000 in taxable pension income.

f/ If the tax credit for the elderly or the permanently and totally disabled is not taken, the supplemental premium would be $73.44.

As shown in the above table and provided in detail in appendix 2, example 1, under H.R. 2470 and S. 1127 neither a Federal annuitant whose only income is derived from a $6,000 Federal annuity nor a private retiree with income derived solely from $6,000 in social security benefits would be required to pay a supplemental premium in 1988.

The other pension income levels used in our examples would each result in a supplemental premium for both the Federal annuitant and for the private retiree with social security benefits. At the $14,000, $20,000, and $30,000 income levels, the supplemental premium for the Federal annuitant would be equal to or larger than the premium for the private retiree with social security benefits. The reason for the higher premium amount for the Federal annuitant is that the Federal pension is taxed to a greater extent (in our examples we assumed that 90 percent was taxed) than social security benefits. Since the supplemental premiums are based on income (adjusted gross income in H.R. 2470 and tax liability in S. 1127), the higher the income, the higher the supplemental premium.

At the $14,000 income level, under H.R. 2470 the Federal annuitant, in our example would pay an annual supplemental premium that would be almost 7 times greater than the supplemental premium for the private retiree. Under S. 1127, the Federal annuitant's supplemental premium would be 4 times greater than the private retiree's; if the Federal annuitant did not take the tax credit for the elderly or the permanently and totally disabled, his or her supplemental premium would be 6 times greater than that of the private retiree. (See appendix 2, example 2.)

At the $20,000 income level, our example results in a supplemental premium under H.R. 2470 that would be almost one and a half times greater for the Federal annuitant than for the private retiree; under S. 1127, the Federal annuitant's premium would be two times greater than the premium for the private retiree. (See appendix 2, example 3.)

At the $30,000 income level, under H.R. 2470 the Federal annuitant and the private retiree in our example would pay the same maximum supplemental premium amount; under S. 1127, the Federal annuitant's premium would be more than one and a half times greater than that of the private retiree. (See appendix 2, example 4.)

At the $50,000 income level, under H.R. 2470 the Federal annuitant and the private retiree would pay the same maximum supplemental premium amount. Under S. 1127, the Federal annuitant would pay a premium that is almost 2 percent lower than the private retiree's premium. This is because at this higher income level, half (or $4,500) of the private retiree's $9,000 social security benefit is taxed, resulting in an adjusted gross income amount ($45,500) that is larger than the adjusted gross income of the Federal annuitant ($45,000). (See appendix 2, example 5.)

III. EFFECT OF CATASTROPHIC LEGISLATION ON FEDERAL ANNUITANTS: DUPLICATION OF FEDERAL HEALTH BENEFITS COVERAGE AND MEDICARE BENEFITS

A. Background Information on the Federal Employees Health Benefits Program and Coordination with Medicare

Federal annuitants who meet eligibility requirements may elect to purchase a health benefits plan from the Federal Employees Health Benefits (FEHB) program. The numerous plans from which to choose and their premium rates are the same for Federal annuitants as they are for Federal employees. Although the plans offer a variety of different benefits, all provide some amount of coverage for hospital and physicians' services, and all provide full payment of covered medical expenses once a catastrophic limit on enrollee out-of-pocket expenses has been met. All FEHB plans offer self-only and family coverage, and many plans offer high and low options, the low option providing fewer benefits with greater enrollee cost-sharing amounts than the high option. No plans offer a Medicare supplemental policy (i.e., a plan that only supplements Medicare's benefits, sometimes known as a medigap policy); however, the plans waive their coinsurance and deductible amounts for Medicare beneficiaries.

Premiums for the FEHB plans are shared by the Federal Government and the enrollee, with the Federal Government paying approximately 60 percent of the premium.

According to a survey conducted by the General Accounting Office, approximately 53 percent of Federal annuitants and survivors age 65 and older (543,000 individuals) were covered by both the FEHB program and Medicare Part A as of December 1981. In testimony before the Senate Governmental Affairs Committee on September 23, 1987, a representative of the Office of Personnel Management (OPM) stated that the number of annuitants covered by both programs is approximately 760,000. OPM has begun an effort to secure more accurate data by matching their annuity records with Medicare beneficiary files.

The benefits available under the various FEHB plans frequently duplicate or are more generous than the benefits available under the current Medicare program, particularly the benefits for catastrophic coverage and inpatient hospital services. Since Medicare is the primary payer of a medical bill when a Federal annuitant has both Medicare and a FEHB plan, the FEHB plan pays (according to its coverage and reimbursement rules) only the remaining portion of the bill, generally waiving any deductible or coinsurance amounts for the Medicare beneficiary. In this manner, often 100 percent of the medical bill for a Federal annuitant with both coverages is reimbursed.

Many Federal annuitants with FEHB coverage who wish to continue their FEHB coverage after becoming eligible for Medicare frequently enroll in a low option FEHB plan, thus reducing the extent of duplication of the Medicare and the FEHB plan benefits and paying a lower FEHB premium than they would under a high option plan. (An exception might be a Federal annuitant eligible for both FEHB and Medicare who purchases family coverage under a FEHB plan in order to provide insurance for a spouse under age 65 and not yet eligible for Medicare coverage, if the annuitant wants more extensive coverage for the spouse than that provided by low option.)

However, even the low option FEHB plans duplicate Medicare's coverage to some degree. Because Medicare is primary payer, Federal annuitants with Medicare generally have low claims costs under the FEHB plan. However, such annuitants pay the same premium as the other enrollees (e.g., employees or Federal annuitants without Medicare) in that FEHB plan. This means that the FEHB annuitant with Medicare coverage (and the Federal Government which pays its 60 percent premium share) is subsidizing a portion of a FEHB plan's costs for all who purchase that plan because that annuitant is overpaying for the benefits he or she actually receives from that FEHB plan.

The issue of better coordination between the FEHB program and Medicare has been raised several times in the past. The Social Security Amendments of 1972 (P.L. 92-603) provided in Section 1862(c) of the Social Security Act that beginning January 1, 1975, Medicare would not pay for services also covered under a FEHB plan unless the FEHB program were modified to make available to Medicare-eligible FEHB enrollees one or more health benefits plans which supplemented Medicare. The deadline was extended until January 1, 1976, by P.L. 93-480. After considering proposals from the Administration and from the General Accounting Office for coordination of the two programs, Congress included in P.L. 94-182 a repeal of Section 1862(c), indicating in a Finance Committee report (Senate Report No. 94-549) that:

> The substantial costs of these proposals need to be weighed against the increased benefit protection or improved equity they would provide for people covered under both FEHB and medicare. . . . Although it can be argued that more generous provisions than now exist for coordination of FEHB and medicare are merited, the committee is not convinced that equity requires the Government to substantially increase its expenditures under the two programs in an effort to accomplish this. . . . Some offsetting of the benefits of one program against the other, such as now exists, seems justified in view of the major contributions the Government makes toward the financing of both programs.

One issue discussed in the early 1970's FEHB/Medicare coordination debate is that the subsidy that Medicare-eligible Federal annuitants provide to a FEHB plan would no longer exist if such annuitants were offered the opportunity to leave the pool of all enrollees covered by the plan to purchase a Medicare supplemental policy option. Depending on the number of such annuitants in that plan, the loss of this subsidy could result in increased premium costs to all enrollees who remain in the pool (including employees and Federal annuitants not eligible for Medicare).

Subsequent examination of coordination between Medicare and FEHB occurred during consideration of the Omnibus Budget Reconciliation Act of 1981 (P.L. 97-35) when a proposal was made, but not adopted, to make Medicare a secondary payer to the FEHB program. In 1982, a study of the FEHB program by William M. Mercer, Incorporated, commissioned by the House Committee on Post Office and Civil Service, recommended that health benefits for annuitants under FEHB should be separate from those for active employees. Suggested in their report (Review of the Federal Employees Health Benefits Program, July 1982) were a number of changes affecting Medicare-eligible annuitants, including a proposal that "the form of coordination of Medicare be changed from the current double-coverage provision to a Medicare integration provision." Several bills introduced in the 98th Congress included provisions for Medicare supplemental policies under the FEHB program (S. 1685, Durenberger; S. 2027, Stevens); hearings were held, but neither bill was enacted.

B. Discussion of the Effect of Medicare Catastrophic Legislation on Federal Annuitants Eligible for FEHB and Medicare

If Medicare benefits are expanded by the enactment of either Medicare catastrophic coverage bill, greater duplication of the benefits provided by Medicare and the FEHB plans than now exists would occur. The subsidy that Medicare-eligible Federal annuitants currently provide to FEHB plans by paying a FEHB premium for benefits actually paid for by Medicare would also be even greater because Medicare as primary payer would pay an even greater amount of the medical bills of those annuitants under its expanded coverage. In addition, the premiums that such annuitants would pay for FEHB plan coverage would yield them even fewer benefits than would be provided to other FEHB plan enrollees for the same premium.

In addition to the issue of duplication of benefits and overpayment of the FEHB premium, if Medicare were expanded to include the catastrophic coverage provisions, the Medicare-eligible Federal annuitant would be required to pay a new Medicare supplemental premium for catastrophic coverage that he or she might not need because of the relatively generous benefits available under the FEHB plans.

Another issue is that if Medicare-eligible Federal annuitants were required to pay a new Medicare supplemental premium for coverage they are currently already receiving from Medicare and their FEHB plans, their payments would, in effect, substitute for the FEHB premium payment, approximately 60 percent of which is subsidized by the Federal Government. This represents, in effect, a loss of a Federal benefit to which the annuitant is entitled under the FEHB program.

If the Medicare catastrophic coverage provisions were enacted, annuitants eligible for both Medicare and FEHB coverage would have two options if they could not afford or did not wish to pay premiums for duplicative coverage. Similar to the option available to individual purchasers of private medigap policies, they could drop their FEHB plan coverage. However, annuitants might be reluctant to do so because (1) the FEHB program offers a yearly choice of plans that have relatively generous coverage; (2) historically the FEHB program has been comparatively stable, unlike the Medicare program which faces yearly scrutiny during the budget reconciliation process; (3) the FEHB program provides that annuitants who cancel their enrollment in the FEHB program cannot reenroll, preventing the annuitant from rejoining the FEHB program if in the future he perceives that Medicare's benefits are less favorable or its premiums are too expensive; (4) the annuitant receives a FEHB premium subsidy of approximately 60 percent from the Federal Government; and (5) the annuitant may wish to remain in the FEHB program to cover a spouse who is not yet age 65 and thus not eligible for Medicare and may have no other source of health insurance coverage.

Under S. 1127, another option for a Federal annuitant eligible for both programs would be to cancel enrollment in Part B of Medicare. The annuitant would then not be eligible for any of the Part A or Part B catastrophic coverage changes included in the bill (only current Part A benefits would remain) and would not be required to pay the supplemental premium or the Part B premium, including any Part B increases necessary to fund the catastrophic coverage. Since Medicare-eligible Federal annuitants subsidize the cost of the FEHB program, reducing their Medicare coverage would result in increased costs to the FEHB program. Cancelling Medicare coverage is not an option for a beneficiary under H.R. 2470, where payment of the supplemental premium is required of individuals entitled to Medicare Part A, which is not voluntary.

I hope this information is helpful. Please let us know if we can be of further assistance.

Attachments

APPENDIX 1. 1988 PROPOSED MEDICARE CATASTROPHIC SUPPLEMENTAL PREMIUM AMOUNTS PROVIDED IN H.R. 2470

"If the adjusted gross income for the taxable year is:		The annual premium for the taxable year is:
Over:	But not over:	
$ 0	$ 6,000	$ 0
6,000	6,143	10
6,143	6,287	20
6,287	6,430	30
6,430	6,573	40
6,573	6,716	50
6,716	6,860	60
6,860	7,003	70
7,003	7,146	80
7,146	7,289	90
7,289	7,433	100
7,433	7,576	110
7,576	7,719	120
7,719	7,862	130
7,862	8,006	140
8,006	8,149	150
8,149	8,292	160
8,292	8,436	170
8,436	8,579	180
8,579	8,722	190
8,722	8,865	200
8,865	9,009	210
9,009	9,152	220
9,152	9,295	230
9,295	9,438	240
9,438	9,582	250
9,582	9,725	260
9,725	9,868	270
9,868	10,011	280
10,011	10,155	290
10,155	10,298	300
10,298	10,441	310
10,441	10,585	320
10,585	10,728	330
10,728	10,871	340
10,871	11,014	350
11,014	11,158	360
11,158	11,301	370
11,301	11,444	380
11,444	11,587	390
11,587	11,731	400
11,731	11,874	410
11,874	12,017	420
12,017	12,160	430
12,160	12,304	440
12,304	12,447	450
12,447	12,590	460
12,590	12,734	470
12,734	12,877	480
12,877	13,020	490
13,020	13,163	500
13,163	13,307	510
13,307	13,450	520
13,450	13,593	530
13,593	13,736	540
13,736	13,880	550
13,880	14,023	560
14,023	14,166	570
14,166		580.

APPENDIX 2. THEORETICAL EXAMPLES OF PROPOSED MEDICARE CATASTROPHIC SUPPLEMENTAL PREMIUMS USING DIFFERENT PENSION INCOME ASSUMPTIONS

The assumptions used in calculating the examples that follow include:

--Our hypothetical retirees are single, with no survivor benefits, in 1988.

--The retirees do not itemize deductions when filing income taxes; they take the standard deduction ($3,000), the extra standard deduction for the aged ($750), and a personal exemption ($1,950).

--The retirees take the tax credit for the elderly or the permanently and totally disabled, which is calculated as follows: $5000 minus nontaxable social security benefits minus 1/2(AGI-$7,500) times 15 percent.

--We applied an estimated average 10 percent exclusion percentage to the Federal annuitant's pension income in each example to determine the amount that is not subject to taxation for annuitants who retire after July 1, 1986; however the actual percentage varies depending on the amount of employee contributions, the annual pension, and life expectancy at age of retirement.

--The private retiree's income is assumed to include a certain amount of social security benefits, to which an amount of taxable pension income is added so that the total equals the Federal pension amount. The hypothetical amounts of social security benefits at the various pension income levels used in our examples are as follows: at $6,000 in income, all is assumed to be social security benefits; at $14,000 in income, $7,000 is social security benefits; at $20,000 in income, $8,000 is social security benefits; at $30,000 and $50,000 in income, $9,000 is social security benefits.

--The amount of taxable social security benefits was determined in our examples according to the following standard formula. If the private retiree's adjusted gross income (excluding the yearly social security benefit), plus otherwise tax-exempt interest income, combined with 50 percent of the yearly social security benefit exceeded the $25,000 threshold for individuals, the amount of the social security benefit included in taxable adjusted gross income would be the lesser of (1) one-half of the social security benefit, or (2) one-half of the excess of the following computation over the threshold: the individual's adjusted gross income (excluding the yearly social security benefit), plus otherwise tax-exempt interest income, plus 50 percent of the social security benefit.

EXAMPLE 1. 1988 PROPOSED MEDICARE CATASTROPHIC SUPPLEMENTAL PREMIUMS UNDER H.R. 2470 AND S. 1127 FOR FEDERAL ANNUITANTS VS. PRIVATE RETIREES, $6,000 ANNUAL INCOME

H.R. 2470

	Federal annuitant	Private retiree
Gross income	$6,000 a/	$6,000 b/
Adjusted gross income (Taxable pension amount)	5,400 a/	0 b/
Supplemental premium	0	0

S. 1127

	Federal annuitant	Private retiree
Gross income	$6,000 a/	$6,000 b/
Adjusted gross income (Taxable pension amount)	5,400 a/	0 b/
Standard deduction	-3,000	-3,000
Extra standard deduction for the aged	- 750	- 750
Personal exemption	-1,950	-1,950
Taxable income	0	0
Income tax bracket	NA	NA
Tax liability	0	0
Tax credit for the elderly	0	0
Tax liability after tax credit	0	0
Supplemental premium	0	0

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a/ Assumes a Federal annuity of $6,000, 90 percent (or $5,400) of which is subject to taxation.

b/ Assumes a private retiree income of $6,000 composed entirely of untaxed social security benefits.

EXAMPLE 2. 1988 PROPOSED MEDICARE CATASTROPHIC SUPPLEMENTAL PREMIUMS UNDER H.R. 2470 AND S. 1127 FOR FEDERAL ANNUITANTS VS. PRIVATE RETIREES, $14,000 ANNUAL INCOME

H.R. 2470

	Federal annuitant	Private retiree
Gross income	$14,000 a/	$14,000 b/
Adjusted gross income (Taxable pension amount)	12,600 a/	7,000 b/
Supplemental premium	470	70

S. 1127

	Federal annuitant	Private retiree
Gross income	14,000 a/	14,000 b/
Adjusted gross income (Taxable pension amount)	12,600 a/	7,000 b/
Standard deduction	-3,000	-3,000
Extra standard deduction for the aged	- 750	- 750
Personal exemption	-1,950	-1,950
Taxable income	6,900	1,300
Income tax bracket	15%	15%
Tax liability	1,035	195
Tax credit for the elderly	- 367 c/	0
Tax liability after tax credit	668 c/	195
Supplemental premium	48.96 c/	12.24

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a/ Assumes a Federal annuity of $14,000, 90 percent (or $12,600) of which is subject to taxation.

b/ Assumes a private retiree income of $14,000 composed of $7,000 in untaxed social security benefits and $7,000 in taxable pension income.

c/ If the tax credit for the elderly were not taken, the supplemental premium would be $73.44.

EXAMPLE 3. 1988 PROPOSED MEDICARE CATASTROPHIC SUPPLEMENTAL PREMIUMS UNDER H.R. 2470 AND S. 1127 FOR FEDERAL ANNUITANTS VS. PRIVATE RETIREES, $20,000 ANNUAL INCOME

H.R. 2470

	Federal annuitant	Private retiree
Gross income	$20,000 a/	$20,000 b/
Adjusted gross income (Taxable pension amount)	18,000 a/	12,000 b/
Supplemental premium	580	420

S. 1127

Gross income	20,000 a/	20,000 b/
Adjusted gross income (Taxable pension amount)	18,000 a/	12,000 b/
Standard deduction	-3,000	-3,000
Extra standard deduction for the aged	- 750	- 750
Personal exemption	-1,950	-1,950
Taxable income	12,300	6,300
Income tax bracket	15%	15%
Tax liability	1,845	945
Tax credit for the elderly	0	0
Tax liability after tax credit	1,845	945
Supplemental premium	146.88	73.44

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a/ Assumes a Federal annuity of $20,000, 90 percent (or $18,000) of which is subject to taxation.

b/ Assumes a private retiree income of $20,000 composed of $8,000 in untaxed social security benefits and $12,000 in taxable pension income.

EXAMPLE 4. 1988 PROPOSED MEDICARE CATASTROPHIC SUPPLEMENTAL PREMIUMS UNDER H.R. 2470 AND S. 1127 FOR FEDERAL ANNUITANTS VS. PRIVATE RETIREES, $30,000 ANNUAL INCOME

H.R. 2470

	Federal annuitant	Private retiree
Gross income	$30,000 a/	$30,000 b/
Adjusted gross income (Taxable pension amount)	27,000 a/	21,250 b/
Supplemental premium	580	580

S. 1127

	Federal annuitant	Private retiree
Gross income	30,000 a/	30,000 b/
Adjusted gross income (Taxable pension amount)	27,000 a/	21,250 b/
Standard deduction	-3,000	-3,000
Extra standard deduction for the aged	- 750	- 750
Personal exemption	-1,950	-1,950
Taxable income	21,300	15,550
Income tax bracket	28%	15%
Tax liability	3,644	2,332
Tax credit for the elderly	0	0
Tax liability after tax credit	3,644	2,332
Supplemental premium	293.76	183.60

---

a/ Assumes a Federal annuity of $30,000, 90 percent (or $27,000) of which is subject to taxation.

b/ Assumes a private retiree income of $30,000 composed of $9,000 in social security benefits ($250 of which is taxable) and $21,000 in taxable pension income.

EXAMPLE 5. 1988 PROPOSED MEDICARE CATASTROPHIC SUPPLEMENTAL PREMIUMS UNDER H.R. 2470 AND S. 1127 FOR FEDERAL ANNUITANTS VS. PRIVATE RETIREES, $50,000 ANNUAL INCOME

H.R. 2470

	Federal annuitant	Private retiree
Gross income	$50,000 a/	$50,000 b/
Adjusted gross income (Taxable pension amount)	45,000 a/	45,500 b/
Supplemental premium	580	580

S. 1127

	Federal annuitant	Private retiree
Gross income	50,000 a/	50,000 b/
Adjusted gross income (Taxable pension amount)	45,000 a/	45,500 b/
Standard deduction	-3,000	-3,000
Extra standard deduction for the aged	- 750	- 750
Personal exemption	-1,950	-1,950
Taxable income	39,300	39,800
Income tax bracket	28%	28%
Tax liability	8,684	8,824
Tax credit for the elderly	0	0
Tax liability after tax credit	8,684	8,824
Supplemental premium	697.68	709.92

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a/ Assumes a Federal annuity of $50,000, 90 percent (or $45,000) of which is subject to taxation.

b/ Assumes a private retiree income of $50,000 composed of $9,000 in social security benefits ($4,500 of which is taxable) and $41,000 in taxable pension income.